Supreme Court, U.S.
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No. 97-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

NACCO INDUSTRIES, INC.,

Petitioner,

v.

ROGER W. TRACY, TAX COMMISSIONER OF OHIO,

Respondent.

Petition for a Writ of Certiorari to the Supreme Court of Ohio

PETITION FOR A WRIT OF CERTIORARI

TIMOTHY B. DYK
(Counsel of Record)
GREGORY A. CASTANIAS
PAUL R. REICHERT
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

CHARLES M. STEINES
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939

Counsel for Petitioner

QUESTIONS PRESENTED

Ohio's corporate franchise tax taxes gains on the sale of United States Treasury Bonds and other federal obligations, but excludes gains on the sale of comparable state obligations. This case presents the following questions:

1. Whether Ohio's discriminatory tax violates 31 U.S.C. § 3124(a), which bars "each form of taxation that would require the [United States] obligation, the interest on the obligation, or both, to be considered in computing a tax . . . ."

2. Whether Ohio's tax impermissibly discriminates against holders of federal obligations in violation of the intergovernmental tax immunity doctrine under the Supremacy Clause of the United States Constitution.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings in the Ohio Supreme Court were NACCO Industries, Inc. and Roger W. Tracy, Tax Commissioner of Ohio.

Pursuant to this Court's Rule 29.6, NACCO Industries, Inc. states that it has no parent companies. NACCO Industries, Inc. owns 97.62% of Hyster-Yale Material Handling, Inc., which owns 100% of NACCO Materials Handling Group, Inc. In turn, NACCO Materials Handling Group, Inc. owns 20% of Yale Financial Services, Inc., and a 50% interest in Sumitomo-Yale Co., Ltd. (Japan). NACCO Industries, Inc. also owns The North American Coal Corporation, which owns partial interests in two Texas partnerships — approximately 36.7% of Dos Republicas Coal Partnership and 50% of Red River Mining Company.

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PETITION FOR A WRIT OF CERTIORARI

NACCO Industries, Inc. ("NACCO") respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of Ohio in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Ohio is reported at 681 N.E.2d 900. It is reprinted at pages 1a-11a of the appendix to this petition. The decision and order of the Ohio Board of Tax Appeals is unreported. It is reprinted at pages 12a-20a of the appendix to this petition.

JURISDICTION

The judgment of the Supreme Court of Ohio was entered on August 6, 1997. On October 23, 1997, Justice Stevens extended the time for filing a petition of certiorari to and including November 24, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of Article VI, section 2 to the United States Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 3124 of Title 31, United States Code, provides:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax or another nonproperty tax

instead of a franchise tax, imposed on a corporation; and (2) an estate or inheritance tax.

(b) The tax status of interest on obligations and dividends, earnings, or other income from evidences of ownership issued by the Government or an agency and the tax treatment of gain and loss from the disposition of those obligations and evidences of ownership is decided under the Internal Revenue Code of 1954 (26 U.S.C. 1 et seq.). An obligation that the Federal Housing Administration had agreed, under a contract made before March 1, 1941, to issue at a future date, has the tax exemption privileges provided by the authorizing law at the time of the contract. This subsection does not apply to obligations and evidences of ownership issued by the District of Columbia, a territory or possession of the United States, or a department, agency, instrumentality, or political subdivision of the District, territory, or possession.

Section 5733.04(I) of the Ohio Revised Code provides, in pertinent part:

(I) "Net income" means the taxpayer's taxable income before operating loss deduction and special deductions, as required to be reported for the taxpayer's taxable year under the Internal Revenue Code, subject to the following adjustments:

* * *

(5) Deduct any interest or interest equivalent on public obligations and purchase obligations to the extent included in federal taxable income. As used in divisions (I)(5) and (6) of this section, "public obligations," "purchase obligations," and "interest or interest equivalent" have the same meanings as in section 5709.76 of the Revised Code.

(6) Add any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income.

Section 5709.76 of the Ohio Revised Code provides, in pertinent part:

(A) All of the following are exempt from taxes levied by the state and its subdivisions:

(1) Public obligations;

(2) Interest or interest equivalent on public obligations and on purchase obligations;

(3) The transfer, and any profit made on the sale, exchange, or other disposition, of public obligations.

* * *

(D) As used in this section:

* * *

(5) "Public obligations" means public securities, fractionalized interests in purchase obligations, and any obligation or evidence of obligation to pay interest or interest equivalent on public securities or on fractionalized interests in purchase obligations, and does not include purchase obligations.

(6) "Public securities" means bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing issued by the state or a subdivision, or by any nonprofit corporation authorized to issue public securities for or on behalf of the state or a subdivision, to evidence the obligation of the state, subdivision, or nonprofit corporation to repay money borrowed by, or to pay at any future time other money obligations of, the state, subdivision, or nonprofit corporation, and does not include purchase obligations. Public securities may be in the form of either certificated securities or uncertificated securities, as those terms are defined in section 1308.01 of the Revised Code.

STATEMENT

This case presents important questions regarding the limitations upon discriminatory state taxation imposed both by 31 U.S.C. § 3124(a) and by the intergovernmental tax immunity doctrine of the Constitution's Supremacy Clause.

NACCO's Activities. On September 27, 1982, for investment purposes, NACCO purchased for $6,100,003 a fifteen-year U.S. Treasury Bond with a principal amount of $8,000,000. App. 12a. On May 5, 1989, NACCO sold this bond for $7,694,071. NACCO realized a $1,467,493 long-term capital gain from the sale of this bond; the remaining $126,575 represented accrued but unpaid interest. App. 1a. Because Ohio's franchise tax excludes consideration of gain from the sale of Ohio-issued obligations, it was NACCO's belief, in view of the applicable federal statutory and constitutional restrictions, that the capital gain from the sale of this federal obligation could likewise not be considered in the calculation of the franchise tax. Accordingly, NACCO did not include the $1,467,493 gain as part of its net income in calculating its 1990 Ohio franchise tax return, and it "flagged this issue in a separate statement" submitted with the return. *See* Transcript of Hearing Before the Ohio Board of Tax Appeals ("Tr.") at 12-14; App. 12a.

The Ohio Franchise Tax. Under Ohio law, the initial base for calculating a corporation's net income is its federal taxable income before any operating loss or special deductions. *See* Ohio Rev. Code Ann. § 5733.04(I).[1] In calculating net income, gains from the sale of federal obligations are included in income, while gains from the sale of state obligations are not. This result occurs because corporations may "[a]dd any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income."

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[1] The State of Ohio requires corporations to calculate their franchise tax on both a net worth and a net income basis, and to pay the greater amount. *See* Ohio Rev. Code Ann. § 5733.06. Here, the net income calculations yielded the greater tax liability.

Ohio Rev. Code Ann. § 5733.04(I)(6). A "public obligation" under this provision is defined to include "public securities," *see* Ohio Rev. Code Ann. §§ 5733.04(I)(5), 5709.76(D)(5); in turn, the definition of "public securities" includes "bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing *issued by the state or a subdivision*." Ohio Rev. Code Ann. § 5709.76(D)(6) (emphasis added). However, the definition of "public securities" does not include obligations issued by the federal government.

The Tax Commissioner's Assessment. When NACCO filed its 1990 Ohio Corporate Franchise Tax Report, it excluded from its tax base, as determined by the net income method, the $1,467,493 gain NACCO realized from the sale of its treasury bond. App. 12a; Tr. 12-13. On October 14, 1993, the Ohio Department of Taxation issued a franchise-tax assessment to NACCO for the 1990 tax year in the amount of $116,202.58, plus $37,343 in interest. The Department of Taxation concluded that the gain realized by NACCO from the sale of its U.S. Treasury Bond should have been included in NACCO's 1990 Ohio franchise tax base under the net income method. App. 12a-13a.

On November 12, 1993, NACCO filed a Petition for Reassessment, objecting to the franchise-tax assessment on the ground that inclusion of the gain from the sale of the U.S. Treasury Bond in calculating its Ohio franchise tax base violated the United States Constitution because (1) it impermissibly discriminated against federal obligations by excluding similar gains from the sale of obligations issued by the State of Ohio from the franchise tax, and (2) it violated 31 U.S.C. § 3124(a) since the state statute required the "obligation . . . to be considered in computing the tax."[2] App. 13a. The Tax

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[2] Section 3124(a) of Title 31, United States Code, provides in pertinent part:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The

Commissioner, however, rejected NACCO's arguments and issued his final determination on September 28, 1995, affirming the Department of Taxation's assessment.

Proceedings Before The Board of Tax Appeals. NACCO appealed from the Tax Commissioner's determination to the Ohio Board of Tax Appeals ("BTA") on October 27, 1995. The state did not dispute that the statute taxed the gain from the sale of federal obligations while exempting gain from the sale of state obligations. During a March 26, 1996, hearing before a BTA hearing examiner, NACCO presented unrebutted testimony from an expert financial witness from the Ohio State University, Stephen A. Buser, who testified that if gain from the sale of federal, but not state, obligations was taxable by the state, the federal government "would have to increase the interest rate" on new bonds "to compensate for the negative tax consequence"; existing bonds, similarly, "would be placed at a disadvantage." Tr. 25-26. Buser testified that because "[i]t is generally accepted that securities all compete for roughly the same set of investment dollars," any attribute that makes a particular security "becom[e] incrementally less attractive" would either cause "that security [to] drop out of the investment opportunity set," or the issuing agency would have to compensate for that burden in some other way "to make investors still want to hold those securities." Tr. 26-27.

On June 7, 1996, the BTA affirmed the Tax Commissioner's final determination. App. 12a-20a. Because the only issues presented on appeal to the BTA were constitutional ones (preemption under 31 U.S.C. § 3124, and intergovernmental tax immunity under the Supremacy Clause), the BTA's affirmance was largely *pro forma* — Ohio law provides that the BTA acts as a "receiver of evidence," but "cannot rule on" constitutional

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exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax. . . .

questions; the latter task is left solely to the Ohio Supreme Court. *MCI Telecommunications Corp. v. Limbach*, 625 N.E.2d 597, 599 (Ohio), *cert. denied*, 513 U.S. 818 (1994). Accordingly, the BTA held that it was "beyond the jurisdiction of the Board of Tax Appeals" to decide the two constitutional questions presented by NACCO's appeal, and it affirmed the Tax Commissioner's final determination. App. 20a.

Proceedings Before The Ohio Supreme Court. In accordance with Ohio practice, NACCO appealed the BTA's ruling to the Ohio Supreme Court. NACCO reurged its twin arguments that Ohio's taxation of gains realized from the sale of its U.S. Treasury Bond — but not from the sale of similar state obligations — was prohibited both under 31 U.S.C. § 3124 and by the United States Constitution under the intergovernmental tax immunity doctrine. App. 2a.

The Tax Commissioner opposed both arguments. Again, the differential treatment of gain from state and federal obligations was admitted. With respect to section 3124, the Commissioner urged that the Ohio franchise tax's consideration of "gains realized from the sale of federal obligations" does not fall within section 3124(a)'s prohibition upon "each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax." Comm'rs Br. at 8-14. Significantly, however, the Commissioner did not argue that, if the Ohio tax scheme were covered by section 3124(a), the Ohio franchise tax would fall within the statutory exception for "a nondiscriminatory franchise tax . . . imposed on a corporation." 31 U.S.C. § 3124(a)(1).

With respect to NACCO's intergovernmental tax immunity argument, the Commissioner urged that NACCO was erroneously "focus[ing] on only part of the provision that it attacks" (*i.e.*, the admittedly differential treatment of federal and state obligations). Comm'rs Br. at 15. Instead, the Commissioner urged, NACCO was required to "consider the whole statute," including the provision that requires the add-back of losses from the sale of state obligations but not federal obligations (Ohio Rev.

Code Ann. § 5733.04(I)(6)). Comm'rs Br. at 15-17. According to the Commissioner, NACCO's intergovernmental tax immunity argument suffered from a failure of proof because NACCO's expert witness could not express an opinion as to whether the overall "economic effect of the statutory scheme . . . would be a positive or a negative one as to the marketability of federal obligations." *Id.* at 16.

The Ohio Supreme Court's Decision. The Ohio Supreme Court affirmed the decision of the Board of Tax Appeals, recognizing the differential treatment and adopting much the same reasoning advanced by the Commissioner.

The court first held that 31 U.S.C. § 3124 did not prohibit the application of Ohio's franchise tax to the gain from NACCO's sale of the U.S. Treasury Bond. It concluded, despite the statutory language, that section 3124(a), "[b]y its terms . . . does not extend to gains from the sale of federal obligations." App. 4a. The Ohio court viewed its construction of the statute as compelled by this Court's decision in *Nebraska Department of Revenue v. Loewenstein*, 513 U.S. 123 (1994). *Loewenstein* involved private "repurchase agreements" — two-step loan transactions in which security holders temporarily transfer their federal securities to a trust in exchange for a cash loan, which is later paid back to the trust (with interest on the loan) in exchange for a return of the securities. This Court held that the interest received was interest on loans of cash, not interest on "obligations of the United States Government." *Id.* at 129. According to the Ohio Supreme Court, NACCO's gain was similar to the non-exempt interest in *Loewenstein* — it was "attributable to a contractual relationship between two private parties," and "not attributable to redemption of the obligations or payment by the United States government." App. 5a.

The Ohio Supreme Court also viewed its construction of the statute as compelled by canons of statutory construction, relying on differences in language between the statute involved here (31 U.S.C. § 3124(a)), and 31 U.S.C. § 3124(b), the Public Debt Act of 1941, which provides for *federal* taxation of United States

government obligations. The court reasoned that section 3124(b), unlike section 3124(a), "incorporates the phrase 'tax treatment of gain and loss from the disposition of these [federal] obligations.' Congress is generally presumed to act intentionally and purposely when it includes particular language in one section of a statute but omits it in another." App. 4a (citing *Chicago v. Environmental Defense Fund,* 511 U.S. 328, 338 (1994)). Like the Commissioner, the Ohio Supreme Court did not even advert to section 3124(a)(1)'s exception for "a nondiscriminatory franchise tax . . . imposed on a corporation."

The court also rejected NACCO's intergovernmental tax immunity argument. The court held that Ohio's imposition of tax on gain from federal obligations is "'far too attenuated' from the doctrine's concern with the borrowing power of the United States to support constitutional immunity." App. 6a-7a (quoting *Rockford Life Ins. Co. v. Illinois Dep't of Revenue,* 482 U.S. 182, 190 (1987)). Addressing NACCO's argument that the tax was invalid under the antidiscrimination component of the intergovernmental tax immunity doctrine, the Ohio court adverted to the holding of *United States v. County of Fresno,* 429 U.S. 452, 460 (1977), that "[s]o long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory . . . or until Congress declares otherwise" (App. 4a (quotation omitted)), and concluded that Congress had somehow "declared otherwise" in section 3124(a) — even though that section on its face gives no approval to discriminatory taxation. Thus, the court held that "Ohio's franchise tax is valid, regardless of whether it is discriminatory." App. 9a.

Finally, even though the court stated that it did not need to consider whether the Ohio franchise tax discriminated against the federal government, the court nonetheless concluded that NACCO had failed to prove discrimination. Citing no authority, the Ohio court held that NACCO, to prevail, had to show as a factual matter that, taking *all* provisions of the Ohio franchise tax into account, "any difference in treatment between state and federal obligations affects or impedes a function of the federal government; in this case, the marketability of federal obligations."

App. 10a. Even though NACCO's expert witness had concluded that deducting gains from the sale of Ohio public obligations but not federal obligations "would place federal obligations at a disadvantage in the market" (App. 10a), the court held this evidence to be insufficient as a matter of law to demonstrate discrimination. The court relied on the fact that Ohio also required corporations to add back losses from the sale of state obligations, and that the same was not true of losses from federal obligations. Since NACCO's expert could not express an opinion about the relative marketability of federal obligations when both the deduction of gains and the addition of losses from the sale of state obligations but not federal obligations are taken into account, the court concluded that "NACCO has failed to establish that the franchise tax discriminates against the federal government or those with whom it deals." App. 11a.

REASONS FOR GRANTING THE WRIT

This case raises important questions concerning the federal statutory and constitutional limitations upon state taxation of federal obligations.

I. IN HOLDING THAT THE OHIO TAX DID NOT VIOLATE 31 U.S.C. § 3124, THE OHIO SUPREME COURT MISINTERPRETED THIS COURT'S DECISION IN *NEBRASKA DEPARTMENT OF REVENUE v. LOEWENSTEIN*

Section 3124(a) of Title 31, United States Code, provides in part:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax . . . .

This Court has held that this statute "establishes a broad exemption of federal obligations from state and local taxation,"

Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 395 (1983), a "sweeping" exemption that extends to "*every form*" of state taxation where "federal obligations must be considered, either directly or indirectly, in *computing* the tax." *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 862 (1983) (emphasis in original). The Ohio Supreme Court nonetheless held that Ohio's franchise tax, which taxes gains from the sale of federal but not state obligations, did not violate section 3124(a).[3] The court reached this conclusion based upon a misreading of this Court's decision in *Nebraska Department of Revenue v. Loewenstein*, 513 U.S. 123 (1994), and by a fundamental misapplication of statutory construction principles at odds with this Court's teachings. Certiorari should be granted to resolve these conflicts.

There was no contention in *Loewenstein* that the state tax at issue impermissibly "require[d] the obligation . . . to be considered in computing the tax," and the Court's approval of the Nebraska tax cannot possibly be read as approving state taxation of gains from the sale of federal obligations. The sole question presented to this Court in *Loewenstein* was whether interest earned by a taxpayer from repurchase agreements ("repos") involving federal securities was immune from state tax under section 3124(a) as "interest on" an "[o]bligatio[n] of the United States Government." "Repos" are two-step loan transactions in which the holder of a federal obligation transfers the obligation to a trust, which then makes a cash loan to the holder. Under the repo agreement, the holder later pays back the loan to the trust, with an agreed-upon rate of interest not tied to the interest rate on

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[3] The Ohio Supreme Court did not hold, and respondent has never argued, that Ohio's franchise tax on corporations is "a nondiscriminatory franchise tax . . . imposed on a corporation" sufficient to satisfy one of the two express exceptions to 31 U.S.C. § 3124(a). Nor could it be seriously maintained that the franchise tax is "nondiscriminatory" in view of the patently discriminatory treatment of gains from federal obligations *vis-a-vis* state obligations. See discussion at pages 16-20, below.

the federal obligation, in exchange for the return of the obligation. This Court held that the "interest" earned by the taxpayer from his transaction with the trust was not tax-exempt "interest on the obligation," 31 U.S.C. § 3124(a), but instead was taxable "interest on loans of cash from the Trusts to the Seller-Borrower." *Loewenstein,* 513 U.S. at 129.

Unlike *Loewenstein,* this case does not present the question of whether gain on the sale of a federal obligation is "interest on the obligation." The court below plainly misunderstood *Loewenstein* when it held that because "the income at issue here is not attributable to redemption of the obligations or payment by the United States government," but was "attributable to a contractual relationship between two private parties," the gain realized by NACCO from its sale of the treasury bond was permissibly taxed under 31 U.S.C. § 3124(a). App. 5a. *Loewenstein* does not rest on the ground that section 3124(a) applies only to income from United States government redemptions or interest payments, and the statutory language could not possibly support such a reading.

Section 3124(a) prohibits taxation of gains from the sale of federal securities, because taxation of such gains "require[s] the obligation . . . to be considered in computing a tax." 31 U.S.C. § 3124(a). This provision prohibits not only tax on the "redemption of the obligations or payment by the United States government" (App. 5a), but prohibits *all* taxes that take the *value* of the obligation into account, whether directly or indirectly. As *Loewenstein* itself explained, "[b]y contrast" to the treatment of interest under section 3124(a), "[t]he obligation itself is 'considered' *when its value is 'taken into account, or included in the accounting,'* in computing the taxable value of a taxpayer's assets or net worth for the purpose of a property tax or the like." 513 U.S. at 128-29 (emphasis added; quoting *American Bank & Trust Co. v. Dallas County,* 463 U.S. at 862). The Ohio tax on the "gain" recognized on the sale of the obligation thus obviously "take[s] into account" the "*value*" of the obligation — indeed, the dictionary definition of "gain" is "[a]ppreciation in *value* or worth *of securities* or property." *Black's Law Dictionary* 678 (6th ed. 1990) (emphasis added).

The Ohio court's refusal to give effect to the plain language of section 3124(a), coupled with its misreading of this Court's *Loewenstein* decision, resulted in a highly formalistic construction of section 3124(a). Such formalism is contrary both to the statute's "broad exemption" (*Memphis Bank & Trust Co. v. Garner*, 459 U.S. at 395), and to congressional intent. As this Court recognized in *American Bank & Trust Co. v. Dallas County*, section 3124(a) (then known as Rev. Stat. § 3701, or 31 U.S.C. § 742) was amended in 1959 to overturn "this Court's rather formalistic pre-1959 approach to § 3701," under which the Court had "consistently held" that "§ 3701 did not prohibit nondiscriminatory taxes imposed on discrete property interests such as corporate shares *or business franchises*, even though the value of that discrete interest was measured by the underlying assets." 463 U.S. at 858 (emphasis added). Up to 1959, "this formal but economically meaningless distinction between taxes on Government obligations and taxes on separate interests was 'firmly embedded in the law.'" *Id.* (quoting *Society for Savings v. Bowers*, 349 U.S. 143, 148 (1955)).[4]

To counter the highly formalistic interpretation announced by this Court, Congress in 1959 added a sweeping sentence to the statute — "'[t]his exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax.'" *Id.* (quoting statute) (Current section 3124(a) contains almost identical language.) This Court has subsequently recognized that "[u]nder the plain language of the 1959 amendment, . . . the tax is barred regardless of its *form* if federal obligations must be considered, either directly or indirectly, in *computing* the tax." 463 U.S. at 862 (emphasis in original). Thus, by enacting section 3124(a) "Congress intended

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[4] Prior to 1959, Rev. Stat. § 3701, 31 U.S.C § 742, provided, in pertinent part, that "[a]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority." *See American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 858 (1983).

to sweep away formal distinctions and to invalidate all taxes measured directly or indirectly by the value of federal obligations." *Id.* at 867. The Ohio Supreme Court's decision, however, impermissibly resurrects the pre-1959 formalism.

The court below exacerbated its erroneous reading of section 3124(a) and *Loewenstein* by an untenable application of statutory construction principles. The court held that because section 3124's *other* subsection, 31 U.S.C. § 3124(b), "incorporates the phrase 'tax treatment of gain and loss from the disposition of those [federal] obligations,'" the logical inference is that Congress meant to exclude "gains from the sale of federal obligations" from the exemption provision of section 3124(a). App. 4a-5a (citing *Chicago v. Environmental Defense Fund,* 511 U.S. 328, 338 (1994)). Such a "negative pregnant" construction of section 3124(a) (*Field v. Mans,* 116 S. Ct. 437, 442 (1995)) has no application where, as here, the two subsections of section 3124 have their origins in two entirely different congressional enactments, and do not possess parallel structure in any event. *See id.* at 446; *see also Gozlon-Peretz v. United States,* 498 U.S. 395, 404 (1991).[5]

The history of the two subsections of section 3124 illustrates this. Section 3124(a) was originally enacted by Congress during the Civil War, Act of Feb. 25, 1862, ch. 33, 12 Stat. 345, codified in 1925 as 31 U.S.C. § 742, amended in 1959 (Pub. L. No. 86-346, § 105, 73 Stat. 621, 622) to "rejec[t] and set aside this Court's rather formalistic pre-1959 approach" (*American Bank & Trust v. Dallas County,* 463 U.S. at 862), and ultimately codified as 31 U.S.C. § 3124(a) in 1982 without substantial change. Prior to the Civil War, it had not been deemed necessary to enact legislation expressly stating that state governments were

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[5] Even where a statute contains the identical term in different subsections (which is not the case here) the term may carry two different meanings — particularly where history and prior practice indicate that the sections should have different meanings. *Dewsnup v. Timm,* 502 U.S. 410, 417-20 (1992).

prohibited by the Constitution from taxing federal securities; the political climate of Civil War times, however, made it necessary for the Congress to do so. *Home Savings Bank v. City of Des Moines*, 205 U.S. 503, 513-14 (1907).

By contrast, section 3124(b) has an entirely different history. Its origins are in the Public Debt Act of 1941, 55 Stat. 7, then codified as 31 U.S.C. § 742a, which was passed to remove the *federal* tax exemption for federal securities, an exemption that originally had been granted in 1917 in order to fund World War I. *See* Act of September 24, 1917, ch. 56, § 7, 40 Stat. 288, 291 ("All such bonds and certificates shall be exempt, both as to principal and interest from all taxation now or hereafter imposed by the United States, any state, or any of the possessions of the United States, or by any local taxing authority . . . .").[6]

The two statutes were joined together by Congress when they were recodified as separate subsections of 31 U.S.C. § 3124 in 1982. *See* Pub. L. No. 97-258, § 3124, 96 Stat. 877, 945. In view of the divergent histories of subsections 3124(a) and 3124(b), and the resultant lack of a parallel structure between those subsections, the "negative pregnant" canon of statutory construction had no place here.

In sum: Certiorari should be granted to correct the Ohio Supreme Court's fundamental misinterpretation of 31 U.S.C.

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[6] The legislative history of then-section 742a made quite clear that the Act "*makes no change* in existing law with respect to the taxation of Federal securities by the States and their political subdivisions . . . ." S. Rep. No. 275, 77th Cong., 1st Sess., *reprinted in* 1947 U.S.C.C.A.N. 1217 (emphasis added). A 1947 adjustment to the text of then-section 742a (Act of June 25, 1947, ch. 147, 61 Stat. 180) caused the House Committee on Ways and Means to reiterate that the passage of section 742a "indicates no intent to permit taxation of Federal securities by other jurisdictions than the Federal government." H.R. Rep. No. 423, 80th Cong., 1st Sess., *reprinted in* 1947 U.S.C.C.A.N. 1218.

§ 3124(a), and of this Court's prior decision in *Nebraska Department of Revenue v. Loewenstein*.[7]

II. CERTIORARI SHOULD BE GRANTED BECAUSE THE OHIO SUPREME COURT'S DECISION CONFLICTS WITH THIS COURT'S DECISION IN *MEMPHIS BANK & TRUST CO. v. GARNER*

The Ohio Supreme Court's constitutional decision also conflicts with this Court's decision in *Memphis Bank & Trust Co. v. Garner, supra*.

The doctrine of intergovernmental tax immunity, as interpreted by this Court, comprises two separate and distinct components. The first component, which is not at issue here, provides an absolute immunity from state taxation, but is limited to taxes imposed "directly against the Government of the United States or its property without the consent of Congress." *United States v. City of Detroit*, 355 U.S. 466, 469 (1958). *See also City of Detroit v. Murray Corp.*, 355 U.S. 489 (1958); *United States v. Township of Muskegon*, 355 U.S. 484 (1958).

The second component, which might be called the "antidiscrimination component" of the doctrine, forbids state taxes that "impos[e] a greater burden on holders of federal property than on holders of similar state property." *Memphis Bank & Trust Co. v.*

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[7] This Court has often granted certiorari to address the question of whether the lower courts have consistently and correctly applied a prior decision of this Court. *See, e.g., Honda Motor Co. v. Oberg*, 512 U.S. 415, 420 (1994); *Barker v. Kansas*, 503 U.S. 594, 597 (1992); *Harte-Hanks Communications, Inc. v. Connaughton*, 491 U.S. 657, 659 (1989); *Hardin v. Straub*, 490 U.S. 536, 536 (1989); *Kuhlmann v. Wilson*, 477 U.S. 436, 444 (1986); *United States v. Powell*, 469 U.S. 57, 61-62 (1984); *Michigan v. Clifford*, 464 U.S. 287, 289 (1984); *Kentucky v. Whorton*, 441 U.S. 786, 787 (1979) (per curiam); *Duren v. Missouri*, 439 U.S. 357, 363 (1979); *Central Hardware Co. v. NLRB*, 407 U.S. 539, 542 (1972); *FTC v. Texaco, Inc.*, 393 U.S. 223, 225 (1968); *Brotherhood of Railway and Steamship Clerks, Freight Handlers, Express and Station Employees v. Allen*, 373 U.S. 113, 118 (1963).

Garner, 459 U.S. at 397. *See also United States v. County of Fresno*, 429 U.S. at 462 ("a state tax imposed on those who deal with the Federal Government" is unconstitutional if the tax "is imposed [un]-equally on . . . similarly situated constituents of the State"). Only where the "tax remains the same whatever the character of the [property] may be" can such a state tax be upheld. *Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492, 493-94 (1956); *see also Memphis Bank & Trust Co. v. Garner*, 459 U.S. at 397-98. Thus, the antidiscrimination component prohibits all state taxes that discriminate "against holders of federal property or those with whom the Federal Government deals." *Id.* at 397. The principal cases relied upon by the Ohio Supreme Court were inapposite to the discrimination issue — they involved the first, narrower component of the doctrine, not the antidiscrimination component.[8]

This Court recognized and applied this antidiscrimination principle in *Memphis Bank & Trust Co. v. Garner*, *supra*. Tennessee's bank tax imposed a tax on the "net earnings" of banks doing business in the state, and "include[d] income from obligations of the United States and its instrumentalities" — but not income from Tennessee obligations — in the tax base. 459 U.S. at 393. The Court held that this discriminatory tax scheme violated the antidiscrimination component of the intergovernmental tax immunity doctrine: "Tennessee discriminates in favor of securities issued by Tennessee and its political subdivisions and against federal obligations. The State does so by including in the tax base income from otherwise comparable state and local obligations." *Id.* at 398. The Court thus concluded that the Tennessee tax was unconstitutionally discriminatory. *Id.* at 398-99.

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[8] *See* App. 6a-8a (citing *Rockford Life Insurance Co. v. Illinois Dep't of Revenue*, 482 U.S. 182 (1987) (upholding nondiscriminatory tax on "Ginnie Mae" bonds issued by private financial institutions), and *Willcuts v. Bunn*, 282 U.S. 216 (1931) (upholding nondiscriminatory federal tax on gains from sale of state and municipal obligations)).

The Ohio Supreme Court plainly misunderstood the antidiscrimination principle. Citing *Memphis Bank & Trust Co. v. Garner,* the court misquoted that case by holding that "a state tax is invalid only if it discriminates against the federal government or those with whom it deals." App. 11a (citing *Memphis Bank & Trust Co. v. Garner,* 459 U.S. at 397). What the cited page of *Memphis Bank & Trust Co. v. Garner* actually says, of course, is that taxes which "discriminate against *holders of federal property* or those with whom the Federal Government deals" are invalid. 459 U.S. at 397 (emphasis added). NACCO was plainly a "holde[r] of federal property," and was plainly discriminated against by Ohio's taxation of its gains from the sale of its federal obligation.

Despite its recognition that the Ohio franchise tax distinguishes between holders of state and federal property (*see, e.g.,* App. 2a ("gain from the sale of an Ohio obligation is exempt from the Ohio franchise tax, while gain from the sale of a federal obligation is not") (footnote omitted)), the Ohio Supreme Court nonetheless held that "Ohio's franchise tax is valid, regardless of whether it is discriminatory." App. 9a. The court reached this conclusion by relying on the rule that a discriminatory tax such as Ohio's franchise tax, even though "not directly laid on the Federal Government," violates the Supremacy Clause unless "Congress declares otherwise." *United States v. County of Fresno,* 429 U.S. at 460 (citation omitted); App. 4a. The court determined that "Congress has 'declared otherwise,'" by impliedly excluding gains from the sale of federal obligations from the scope of 31 U.S.C. § 3124(a)'s immunity. App. 4a. This conclusion was untenable as a matter of statutory construction since section 3124(a) does not remotely indicate congressional approval of discriminatory state franchise taxes. Indeed, as discussed above, Congress specifically *disapproved* of such discriminatory taxes. *See* 31 U.S.C. § 3124(a)(1).

In an attempt to buttress its holding that the discriminatory franchise tax was nonetheless constitutional, the Ohio court held alternatively that NACCO was guilty of a failure of proof. The supreme court held, citing no authority in support, that NACCO

was not only required to prove discrimination; it was also required to "demonstrate that any difference in treatment between state and federal obligations affects or impedes a function of the federal government; in this case, the marketability of federal obligations." App. 9a-10a. No such proof was required. *See, e.g., Memphis Bank & Trust Co. v. Garner,* 459 U.S. at 398 & n.8 (finding unconstitutional discrimination on the face of the statute without resort to expert testimony). In any event, NACCO's expert witness testified that the taxation of gains from federal but not state obligations would place federal obligations at a market disadvantage, and would require the federal government to raise its coupon rate to compensate for the disadvantage. *See* Tr. 26-27. The Ohio court found this testimony insufficient to satisfy the test it had just announced. Instead, the Ohio court said, NACCO's case failed because its expert witness could not express an opinion as to the relative marketability of federal obligations when the *deductibility of losses* from federal but not state obligations was also factored into the overall equation. App. 10a.

The court in effect found that the provision allowing add-back of *losses* from the sale of federal obligations, Ohio Rev. Code § 5733.04(I)(6), was sufficiently "compensatory" for the admittedly discriminatory treatment of *gains* from the sale of federal obligations. No such "compensatory tax" doctrine exists in the intergovernmental immunity area; indeed, none has ever been recognized outside the sales and use tax area. *Oregon Waste Systems, Inc. v. Department of Environmental Quality,* 511 U.S. 93, 105 (1994). But even if a compensatory tax doctrine could be engrafted onto the doctrine of intergovernmental tax immunity, the Ohio Supreme Court's version could not be sustained. This Court has always demanded "strict equality" from "compensatory" taxes (*see, e.g., Halliburton Oil Well Cementing Co. v. Reily,* 373 U.S. 64, 73 (1963)); the Ohio tax fails that requirement. This Court has repeatedly expressed its "unwilling[ness] to plunge . . . into the morass of weighing comparative tax burdens," recognizing that "[t]he complexities of factual economic proof always present a certain potential for error, and courts have

little familiarity with the process of evaluating the relative economic burden of taxes" (*Fulton Corp. v. Faulkner*, 116 S. Ct. 848, 859 (1996) (quotation omitted)); the complex economic testimony required by the Ohio court's newly minted test was likewise contrary to this authority.

At least one other state court has reached a decision contrary to that of the court below. In *Doneski v. Comptroller of the Treasury*, 605 A.2d 649 (Md. Ct. Spec. App. 1992), *cert. denied*, 506 U.S. 1054 (1993), the court held that Maryland's taxation of gains from the sale of federal obligations, while exempting comparable gains from the sale of bonds issued by the State of Maryland, was prohibited both by 31 U.S.C. § 3124(a) and by the intergovernmental tax immunity doctrine. The Maryland court recognized that the underlying purpose of this provision was to prohibit the imposition of state taxes that disadvantage federal obligations in the marketplace. 605 A.2d at 653-54. It found that Maryland's tax scheme "clearly discriminate[d] against the federal government and the people with whom it deals" by "diminishing the investment attractiveness of the United States obligations in favor of state obligations." *Id.* at 654.

In sum: Certiorari should be granted to resolve the conflict between the decision below and this Court's decision in *Memphis Bank & Trust Co. v. Garner*.

III. THE ISSUES PRESENTED BY THIS CASE ARE IMPORTANT

The issues raised by this case have serious implications for the ability of the federal government to borrow money through the issuance of federal obligations. If taxpayers were unable to deduct gains from the sale of federal and state obligations equally, federal obligations would be placed at a distinct disadvantage in the market and rendered less attractive to the investing public. *See Memphis Bank & Trust Co. v. Garner*, 459 U.S. at 398 n.8 (citing data provided by the brief *amicus curiae* of the United States). If Ohio's rule were adopted by other states, the federal government would have to offer a higher interest rate on its securities — ultimately increasing the federal government's cost

of borrowing money — in order to compensate for the market disadvantage imposed on federal obligations by the discriminatory franchise tax. *See, e.g., id.* (noting that "if all 50 States enacted provisions comparable to the Tennessee bank tax, the United States would incur additional borrowing costs estimated at $280 million at an interest rate of 12%").

Even at present, this problem is not limited to Ohio. A number of other states also exempt gains from the sale of state — but not federal — obligations from taxation. For instance, the State of Kansas exempts profits from the sale of certain state obligations from both corporate and individual income tax, but does not provide for a deduction for a gain recognized on the sale of federal obligations. *See, e.g.*, Kan. Stat. Ann. §§ 32-862; 68-2013; 68-2041. In calculating individual income tax, Connecticut provides for a deduction for the gain on a sale of state securities, but does not provide a similar deduction for a gain from the sale of a federal obligation. *See* Conn. Gen. Stat. § 12-701(a)(20). And prior to the decision below, Pennsylvania's Department of Revenue determined that it was "constitutionally obligated" to exclude gains from the sale of federal obligations for corporate net income tax purposes. *See* Pennsylvania Dep't. of Revenue Tax Update No. 16, at 4 (July 1, 1987).

The decision of the Ohio Supreme Court in this case, if left to stand, will surely encourage other states to follow Ohio's lead and adopt similarly discriminatory tax structures. If this decision is not reversed, any state eager to raise revenues and encourage local investment has every incentive to amend its tax statutes to exempt only the gains from the sale of state obligations from state taxation. Such a result clearly would have a significant negative impact on the market for U.S. Treasury Bonds and other federal obligations. Ohio, Kansas and Connecticut already represent a substantial share of the total market for U.S. Treasury Bonds. Granting permission to other states to discriminate against purchasers of federal obligations will impede the marketability of these securities.

Finally, if there is any doubt that the petition should be granted, this Court should seek the views of the United States concerning the issues presented by this petition, particularly in view of the important federal interest in assuring the continued marketability of United States government obligations.

In sum: Certiorari should be granted to consider these issues of national importance.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

TIMOTHY B. DYK
(*Counsel of Record*)
GREGORY A. CASTANIAS
PAUL R. REICHERT
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

CHARLES M. STEINES
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939

Counsel for Petitioner

November 24, 1997

APPENDIX

SUPREME COURT OF OHIO

NACCO Industries,
Appellants.

v.

Roger W. Tracy,
Commissioner of Ohio,
Appellee.

No. 96-1535
Decided August 6, 1997

APPEAL from the Board of Tax Appeals, No. 95-K-1210.

In 1982, NACCO Industries, Inc. ("NACCO") purchased, for $6,100,003, a fifteen-year U.S. Treasury Bond in the principal amount of $8,000,000. Seven years later, NACCO sold the bond for $7,694,071, of which $126,575 represented accrued, but unpaid, interest. NACCO did not include its $1,467,493 gain from the sale of the bond in the calculation of its 1990 Ohio franchise tax.

NACCO objected to the inclusion of the gain on the basis that the Ohio franchise tax impermissibly discriminated against federal obligations because it exempted gains only from the sale of Ohio public obligations. The Ohio Department of Taxation disagreed, included the $1,476,493 gain in NACCO's net income, and increased the assessment in the amount of $116,202. Upon NACCO's petition for reassessment, the Tax Commissioner affirmed the $116,202 assessment plus $37,343 in interest. The Board of Tax Appeals affirmed the final determination of the Tax Commissioner.

This cause is now before the court upon an appeal as of right.

COOK, Justice.

Ohio corporations calculate their franchise tax on both a net worth basis and a net income basis and pay which-ever produces the greater tax. R.C.5733.06. In this case, the relevant calculation is net income. The initial base for the net income tax is federal taxable income before net operating loss and special deductions. R.C. 5733.04(I). From that figure, Ohio corporations are permitted to "[a]dd any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income." R.C. 5733.04(I)(6). For purposes of R.C. 5733.04(I)(6), a "public obligation" is defined as a "public security." R.C. 5733.04(I)(5), 5709.76(D)(5). A "public security," in turn, is defined as "bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing issued by the *state or a subdivision*." (Emphasis added.) R.C. 5709.76(D)(6).

The effect of these definitions is that gain from the sale of an Ohio obligation is exempt from the Ohio franchise tax,[1] while gain from the sale of a federal obligation is not. We decide here whether this taxing scheme violates Section 3124, Title 31, U.S. Code, or is unconstitutional under the doctrine of intergovernmental immunity as embodied in the Supremacy Clause of the United States Constitution. We conclude that Ohio's corporate franchise tax scheme violates neither the statute nor the constitutional doctrine.

With the famous declaration that "the power to tax involves the power to destroy," *McCulloch v. Maryland* (1819), 17 U.S. (4 Wheat.) 316, 431, 4 L. Ed. 579, 607, Chief Justice John

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[1] Notably, this exemption from state taxation for state obligations is necessary to comply with the Ohio Constitution. Section 2k(D)(4), Article VIII of the Ohio Constitution exempts from taxation the interest and other income, *including profits from sales*, from bonds issued for the purpose of financing or assisting in the financing of the cost of public infrastructure capital improvements of municipal corporations, counties, townships and other governmental entities.

Marshall announced the doctrine of federal immunity from state taxation. In *McCulloch*, the court considered Maryland's imposition of a tax on notes issued by any bank established without its authority. The only bank falling into that category was the Bank of the United States. Chief Justice Marshall explained that the federal government "though limited in its powers, is supreme within its sphere of action." *Id.* at 405, 4 L. Ed. at 601. Although both sovereigns could impose taxes, the court held that a state does not have authority to tax an instrument employed by the federal government in the execution of its power. *Id.* at 432, 4 L. Ed. at 608.

From *McCulloch* evolved the doctrine of intergovernmental tax immunity. In *Metcalf & Eddy v. Mitchell* (1926), 269 U.S. 514, 521, 46 S. Ct. 172, 173-174, 70 L. Ed. 384, 391, the court explained that "the very nature of our constitutional system of dual sovereign governments is such as impliedly to prohibit the federal government from taxing the instrumentalities of state government, and in a similar manner to limit the power of the states to tax the instrumentalities of the federal government."

In its early development, the doctrine of intergovernmental immunity was construed to insulate not only direct government functions from taxation, but also derivative transactions relating to the performance of governmental functions. 2 Rotunda & Nowak, Treatise on Constitutional Law (2 Ed.1992) 300, Section 13.9. Ultimately, the court expanded the doctrine to prohibit both a state income tax on federal employees and a federal income tax on state employees. *Dobbins v. Erie Cty. Commrs.* (1842), 41 U.S. (16 Pet.) 435, 10 L. Ed. 1022; *The Collector v. Day* (1870), 78 U.S. (11 Wall.) 113, 20 L. Ed. 122.

In modern times, however, the Supreme Court has adopted "a functional approach to claims of intergovernmental immunity, accommodating of the full range of each sovereign's legislative authority and respectful of the primary role of Congress in resolving conflicts between the National and State governments." *North Dakota v. United States* (1990), 495 U.S. 423, 435, 110 S. Ct. 1986, 1994, 109 L. Ed. 2d 420, 433. Abandoning its early

beginnings, the court apparently has eroded the doctrine to the following: "So long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory * * * or until Congress declares otherwise." *United States v. Fresno Cty.* (1977), 429 U.S. 452, 460, 97 S. Ct. 699, 704, 50 L. Ed. 2d 683, 691.

By enacting Section 3124, Title 31, U.S. Code ("Section 3124"), Congress has "declared otherwise" on the subject of immunity from state taxation for federal obligations. Because the statutory immunity codified at Section 3124(a) is principally a restatement of the constitutional rule, *Rockford Life Ins. Co. v. Illinois Dept. of Revenue* (1987), 482 U.S. 182, 187-188, 107 S. Ct. 2312, 2315, 96 L. Ed. 2d 152, 159, we first view the case at bar under the statutory immunity and then consider whether the constitutional doctrine of intergovernmental immunity requires a broader exemption.

Section 3124 states, in part:

> "(a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation * * * ."

Under this section, the scope of the immunity from state taxation granted by Congress extends only to federal obligations and the interest on such obligations. By its terms, the immunity expressed in Section 3124(a) does not extend to gains from the sale of federal obligations. In contrast, Section 3124(b), Title 31, U.S.Code, regarding federal taxation of federal obligations, incorporates the phrase "tax treatment of gain and loss from the disposition of those [federal] obligations." Congress is generally presumed to act intentionally and purposely when it includes particular language in one section of a statute but omits it in another. *Chicago v. Environmental Defense Fund* (1994), 511

U.S. 328, 338, 114 S. Ct. 1588, 1593, 128 L. Ed. 2d 302, 311. Had Congress intended Section 3124(a) immunity to extend to gains from the sale of federal obligations, it would have expressed that intent in the statute. See *California State Bd. of Equalization v. Sierra Summit, Inc.* (1989), 490 U.S. 844, 854, 109 S. Ct. 2228, 2235, 104 L. Ed. 2d 910, 920.

Moreover, in *Nebraska Dept. of Revenue v. Loewenstein* (1994), 513 U.S. 123, 115 S. Ct. 557, 130 L. Ed. 2d 470, the court upheld a state tax upon interest earned from repurchase agreements involving federal securities under Section 3124. Under these repurchase ("repo") agreements, the owner of the securities agreed to sell and repurchase the securities at a fixed increased price. The original seller retained the interest earned by the securities during the term of the repo agreement. The state exempted from tax the interest paid by the federal government on the federal obligations, but assessed an income tax against the interest paid as a result of the repurchase agreements.

In upholding the state tax, the court found the dispositive question to be whether the interest at issue was earned on the obligations of the United States government. For purposes of Section 3124, the court concluded, the interest was not attributable to redemption of the securities or payment by the United States government. Rather, the interest was income earned as interest on loans to *private parties*. Thus, the court concluded that the income being taxed by the state was not interest from the federal securities and Section 3124 did not prohibit the state from taxing the income.

We similarly find that the dispositive question in this case is whether the income at issue was earned on the obligations of the United States. The income at issue here is not attributable to redemption of the obligations or payment by the United States government. Rather, the income is attributable to a contractual relationship between two private parties. Accordingly, we hold that Section 3124 immunity from state taxation does not extend to Ohio's corporate franchise tax upon the gain from the sales of federal obligations and such a tax is not prohibited by that statute.

We turn now to consider whether the constitutional doctrine of intergovernmental immunity requires any broader exemption than the statute. Before we proceed, however, we are mindful of the Supreme Court's caveat that a "court must proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly established. We do well to remember the concluding words in *Smith v. Davis* (1944), 323 U.S. 111, 119, 65 S. Ct. 157, 161, 89 L. Ed. 107, 113], which although spoken in reference to the statute, are relevant to our role in applying the constitutional doctrine as well: 'All of these related statutes are a clear indication of an intent to immunize from state taxation only the interest-bearing obligations of the United States which are needed to secure credit to carry on the necessary functions of government. That intent, which is largely codified in § 3701, should not be expanded or modified in any degree by the judiciary.'" *Rockford Life Ins. Co.*, 482 U.S. at 191, 107 S. Ct. at 2317-2318, 96 L. Ed. 2d at 161. "[A]bsent congressional action," the court has emphasized, "the States' power to tax can be denied only under the 'clearest constitutional mandate.'" (Citation omitted.) *United States v. New Mexico* (1982), 455 U.S. 720, 738, 102 S. Ct. 1373, 1384, 71 L. Ed. 2d 580, 594.

In *Rockford Life Ins. Co.*, the court considered whether "Ginnie Maes," financial instruments issued by private financial institutions and guaranteed by the Government National Mortgage Association, were exempt from state taxation by either statutory or constitutional intergovernmental immunity. In considering the constitutional immunity, the court turned to the purpose of the constitutional doctrine. The doctrine, the court noted, is based on the proposition that "the borrowing power is an essential aspect of the Federal Government's authority and, just as the Supremacy Clause bars the States from directly taxing federal property, it also bars the States from taxing federal obligations in a manner which has an adverse effect on the United States' borrowing ability." *Id.* at 190, 107 S. Ct. at 2317, 96 L. Ed. 2d at 160.

The court considered the lack of a fixed and certain obligation by the United States on Ginnie Maes "far too attenuated" from the doctrine's concern with the borrowing power of the United

States to support constitutional immunity. *Id.* The court also considered that none of the proceeds from the sale of Ginnie Maes was received by the federal government or used to finance any federal function. *Id.* at 191, 107 S. Ct. at 2317, 96 L. Ed. 2d at 161.

In *Willcuts v. Bunn* (1931), 282 U.S. 216, 51 S. Ct. 125, 75 L. Ed. 304, the court upheld a federal tax upon gains from the sale of state and municipal obligations after a challenge based upon the doctrine of intergovernmental immunity. There, the court rejected the notion that a prohibition of a tax on the interest payable on state and municipal bonds also prohibited a tax upon the profits derived from a sale of such bonds. *Id.* at 227, 51 S. Ct. at 127, 75 L. Ed. at 308. The court observed that the sale of bonds by their owners "is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds." *Id.* The court further noted that "the tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of the use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as 'the creation of capital, industry and skill.'" (Citation omitted.) *Id.* at 227-228, 51 S. Ct. at 127-128, 75 L. Ed. at 308.

The court found particularly persuasive the fact that in a "uniform and long-established practice * * * neither the Federal Government nor the States have found a tax on the profits of the sales of their securities to be a burden on their power to borrow money. So far as we are advised, the Federal Government has not at any time deemed it to be necessary to exempt from taxation the profits realized by owners on the sale of its obligations, with the exception, recently made, of short-term Treasury bills issued

on a discount basis and payable without interest." *Id.* at 232, 51 S. Ct. at 129, 75 L. Ed. at 310.

The *Willcuts* court additionally observed that "it may be doubted whether the prospect on the part of the ordinary investor of obtaining profit on the resale of such obligations is so important an element in inducing their acquisition that a federal tax laid on such profits, in common with profits derived from the sales of other property, constitutes any substantial interference with the functions of state governments. While the tax is laid on gains, there is also a deduction for losses on sales, and whether investors in such securities would consider it an advantage if both provisions were eliminated is a matter of mere speculation. * * * [B]efore we can restrict their application upon the ground of a burden cast upon the State's borrowing power, where the state tax is not laid upon contracts made by the State in the exercise of that power, or upon the amounts payable thereunder, but is laid upon the result of distinct transactions by private owners, it must clearly appear that a substantial burden upon the borrowing power of the State would actually be imposed. But we have nothing but assertion and conjecture." 282 U.S. at 231, 51 S. Ct. at 129, 75 L. Ed. at 310.

From these precedents, it is apparent that the limits of the constitutional doctrine do not extend to a state tax upon gains from the proceeds of a contract between two private parties where there is no demonstrable burden on the federal borrowing power. The nexus between the federal government and the exchange of a federal obligation among private parties is "far too attenuated" from the doctrine's concern with the effect of the tax upon the borrowing power of the United States to support constitutional immunity. *Rockford Life Ins. Co.*, 482 U.S. at 190, 107 S. Ct. at 2317, 96 L. Ed. 2d at 160.

Ohio taxes the proceeds from a transaction between two private parties, a transaction distinct from that of the interest payable on the bonds or the amount payable on the bond itself. The profits from the transaction are realized entirely by the owner of the obligation. None of the proceeds from the sale of the obligations

was received by the federal government or used to finance any federal function. We have no evidence clearly establishing that a substantial burden on the federal government's borrowing power would actually be imposed.

Section 3124 is an indication of an intent to immunize only the federal obligation or the interest on the obligation from state taxation. Until Congress, in its primary role of resolving conflicts between the national and state governments, expressly resolves this conflict to the contrary, we decline to extend the constitutional limits of the immunity doctrine any further than that provided by Section 3124. As a result, we find that neither the statutory nor the constitutional intergovernmental immunity doctrine prohibits Ohio's corporate franchise tax on the gains from the sale of federal obligations.

NACCO argues that our inquiry cannot end here. NACCO contends that under the constitutional doctrine of intergovernmental immunity, any state tax that discriminates against those who deal with the federal government is invalid. We note, however, that under the modern doctrine of intergovernmental immunity, "so long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory * * * *or* until Congress declares otherwise." (Emphasis added.) *Fresno Cty.*, 429 U.S. at 460, 97 S. Ct. at 704, 50 L. Ed. 2d at 691. Since we have determined that Congress has declared otherwise, and we have declined to expand the limits of that immunity further, Ohio's franchise tax is valid, regardless of whether it is discriminatory.

Even assuming that we must consider whether the tax is discriminatory, we would nevertheless uphold Ohio's corporate franchise tax. A state tax impermissibly discriminates against federal obligations where it imposes a greater burden on holders of federal property than it does on holders of similar state property. *Id.* The nondiscrimination rule, however, remains rooted in the principle that the state may not obstruct the activities of the federal government. *North Dakota*, 495 U.S. at 437-438, 110 S. Ct. at 1996, 109 L. Ed. 2d at 435. With this principle in

mind, we find persuasive the Tax Commissioner's argument that in order to establish that the Ohio franchise tax discriminates against federal obligations, NACCO must demonstrate that any difference in treatment between state and federal obligations affects or impedes a function of the federal government; in this case, the marketability of federal obligations. To this end, NACCO's expert testified that in his opinion, the exclusion of gain from the sale of state obligations but not federal obligations would place federal obligations at a disadvantage in the market.

At first glance, this argument appears to support NACCO. In analyzing the constitutionality of a state law, however, it is inappropriate for a court to look to the most narrow provision addressing the issue. *North Dakota*, 495 U.S. at 438, 110 S. Ct. at 1996, 109 L. Ed. 2d at 435. Rather, a determination of whether a tax is discriminatory requires an examination of the state's whole tax structure. *Washington v. United States* (1983), 460 U.S. 536, 542, 103 S. Ct. 1344, 1348, 75 L. Ed. 2d 264, 271. Accordingly, we consider that in addition to requiring corporations to "deduct any gain" on the sale of a state obligation, R.C. 5733.04(I)(6) also requires corporations to "add any loss" on the sale of a state obligation in calculating its net income basis.

NACCO's expert testified that the add back of losses from the sale of state obligations but not federal obligations would place federal obligations at a market advantage. However, NACCO's expert could not express an opinion on the relative marketability of the obligations when accounting for both gains and losses from the sale of federal obligations but not on state obligations in the calculation of net income basis. More than mere conjecture or speculation is required to establish that a tax is unconstitutional. *Rockford Life Ins. Co.*, 482 U.S. at 190, 107 S. Ct. at 2317, 96 L. Ed. 2d at 160, fn. 10.

NACCO cites *Memphis Bank & Trust Co. v. Garner* (1983), 459 U.S. 392, 103 S. Ct. 692, 74 L. Ed. 2d 562, as support for the argument that Ohio's tax discriminates against federal obligations. In *Memphis Bank*, the court found a Tennessee state

tax on interest earnings from federal obligations but not on interest earnings from state obligations violated Section 3124. We find this case distinguishable. In *Memphis Bank*, the tax upon the interest of a federal obligation fell within the scope of Section 3124. Thus, Congress already made the determination that a state tax on the interest of federal obligations would substantially affect a function of government. Here, however, the tax on the gain from the sale of federal obligations does not fall within the scope of Section 3124 and NACCO has not otherwise established that the state tax at issue affects a function of government.

We also consider that a state tax is invalid only if it discriminates against the federal government or those with whom it deals. *Id.* at 397, 103 S. Ct. at 696, 74 L. Ed. 2d at 567. Here, the transaction subject to the tax does not arise directly from the relationship between the taxpayer and the federal government. Rather, the transaction subject to the tax arises from a contractual relationship between two private parties. We find this relationship to the federal government too attenuated to invalidate the Ohio franchise tax. Accordingly, we find that NACCO has failed to establish that the franchise tax discriminates against the federal government or those with whom it deals.

Because we find that Ohio's corporate franchise tax violates neither the statutory intergovernmental immunity nor constitutional intergovernmental immunity, we affirm the decision of the Board of Tax Appeals.

Decision affirmed.

MOYER, C.J., and DOUGLAS, FRANCIS E. SWEENEY, SR., PFEIFER and LUNDBERG STRATTON, JJ., concur.

RESNICK, J., concurs in judgment only.

STATE OF OHIO — BOARD OF TAX APPEALS

NACCO Industries,	)	CASE NO. 95-K-1210
Appellant,	)	(FRANCHISE TAX)
	)	
v.	)	
	)	
Roger W. Tracy, Tax	)	Decision and Order
Commissioner of Ohio,	)	June 7, 1996
Appellee.	)	

DECISION AND ORDER

This cause and matter is before the Board of Tax Appeals as a result of a notice of appeal filed on October 27, 1995 by appellant, NACCO Industries. Appellant appeals a final determination of the Tax Commissioner dated September 28, 1995, in which that official denied appellant's objection to a corporate franchise tax assessment for 1990.

It appears that the facts of this appeal are not in dispute. On September 27, 1982, appellant purchased, for $6,100,003, a fifteen year U.S. Treasury bond in the principal amount of $8,000,000. On May 5, 1989, appellant sold this bond for $7,694,071, realizing and recognizing a gain of $1,467,493 on the sale. When appellant filed its 1990 Ohio Corporate Franchise Tax Report, it excluded the gain on the sale of this bond from its tax base as determined under the net income method. Subsequently, the Department of Taxation assessed appellant $116,202.58 in franchise tax, as well as $37,343.81 in interest, based upon the Department's determination that the gain which

appellant had realized on its sale of the bond should have been included within appellant's net income calculation performed under R.C. 5733.05.

Appellant then filed a petition for reassessment, claiming that Ohio's exclusion of gains realized on state obligations while not providing a comparable exclusion for gains incurred on federal obligations was unconstitutional. In his decision, the Tax Commissioner denied appellant's objection, concluding that the gain which appellant incurred on its sale of a U.S. Treasury bond was not excluded by statute. The Tax Commissioner also stated within his final determination that there existed no unconstitutional infirmity in this regard.

It is from this decision that appellant now appeals, specifying the following single error:

> "The Appellee erroneously determined that Appellant is required to include gain realized on the sale of a federal obligation when calculating the value of its issued and outstanding shares of stock, as determined under the net income method of R.C. [section] 5733.05(B). The federal obligation in question is a ten-year U.S. Treasury Bond in the principal amount of $8,000,000. Appellant purchased the bond on September 27, 1982 for $6,100,003 and sold it on May 5, 1989 for $7,567,500 realizing and recognizing a gain of $1,467,497 on the sale.
>
> "Gain from the sale, exchange, or other disposition of public obligations, — e.g., notes issued by the State of Ohio or a subdivision, evidencing the obligation of the State or subdivision to repay money borrowed by, or to pay at any future time other money obligations of, the State or subdivision — are excluded when calculating the value of taxpayer's issued and outstanding shares of stock, as determined under the net income method. Such disparate treatment is in violation of the Supremacy Clause of the U.S. Constitution and 31 U.S.C. [section] 3124."

This matter is now considered by this Board based upon appellant's notice of appeal, the statutory transcript certified by the Tax Commissioner, the record of the hearing conducted on March 26, 1996 and the brief submitted by appellant. At this Board's hearing, appellant presented the testimony of two witnesses: Kenneth C. Schilling, appellant's manager of tax and budgeting, and Dr. Stephen A. Buser, Associate Dean for Budget at the Ohio State University.

At the outset, it is necessary to address a matter upon which the attorney examiner presiding at hearing reserved ruling. Following appellant's voir dire of Dr. Buser, counsel for the Tax Commissioner objected to this Board receiving the testimony of an expert witness whose identity had not been disclosed prior to hearing. Arguing that exclusion was warranted, counsel cited this Board's rule regarding discovery, which became effective March 1, 1996.[2] Ohio Adm. Code 5717-1-11(A), the rule to which the Tax Commissioner's counsel referred, provides in pertinent part:

> "Discovery may be permitted by deposition upon oral examination or written questions; written interrogatories; production of documents or tangible things or permission to enter land or other property; and requests for admissions. The 'Ohio Rules of Civil Procedure' shall be followed for discovery purposes to the extent they are not inconsistent with other board rules, and subject to the following limitations:

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[2] Counsel also referred to Ohio Adm. Code 5717-1-15(E), which provides as follows:

> "Each party should identify its witnesses and provide copies of the documentary exhibits it plans to offer into evidence (reduced in size, if necessary), to all parties and the attorney examiner, at least seven days prior to the hearing, unless otherwise ordered by the attorney examiner."

Although this rule sets forth the recommended course of practice, its language is not mandatory and there exists no specific sanction for failure to comply. Accordingly, we will limit our discussion to Ohio Adm. Code 5717-1-11(A).

* * * *

"(5) An expert may not be permitted to testify if he or she has not been timely identified prior to hearing. The parties may mutually agree to the exchange of any written reports of expert witnesses to be relied upon by them. Additionally, an expert's report or portions thereof may be excluded from evidence if the report was not made available in a timely fashion to complete a mutually agreed exchange of reports. In all events, the identity of the expert and the written valuation reports shall be provided to counsel seven days prior to hearing, except as otherwise ordered by the attorney examiner."

This is the first occasion in which we have had cause to address a request to exclude the testimony of an expert witness on the basis of an alleged failure to comply with Ohio Adm. Code 5717-1-11(A)(5). Initially, we acknowledge that these rules became effective approximately three weeks prior to the hearing in this matter. As of the date of this hearing, these rules, although made available upon request, had not yet been published in the Ohio Administrative Code. Thus, we find reasonable the representation of appellant's counsel that he was unaware of the specific provision upon which counsel relies.

It is important to point out that the provision for exclusion of an expert's testimony is included within the rule setting forth the manner by which discovery is to proceed before this Board. In this instance, counsel for the Tax Commissioner acknowledged that he had not pursued any discovery of appellant. The purpose of Ohio Adm. Code 5717-1-11(A)(5) is to prevent a party, from whom discovery has been sought, from introducing the testimony of a previously undisclosed expert witness and forcing the party who diligently prepared for hearing to either proceed, perhaps unprepared, or to request a continuance of the hearing.

The language included within this section will not be construed by this Board to permit a party which has not attempted to learn the identity of witnesses through discovery, to achieve, as a sanction, the exclusion of an expert witness at hearing. Cf. *Sindel v. Toledo Edison Co.* (1993), 87 Ohio App. 3d 525,

528-529. This result should be obvious since Ohio Adm. Code 5717-1-11(A)(5) requires only that a party *identify* a witness seven days prior to hearing. Under those circumstances where discovery has not been undertaken, we are unable to find that a party suffers any prejudice, other than that caused by its own inaction, when it learns that the testimony of an expert witness will be offered at hearing.

Finally, it is apparent from counsel's decision to proceed with his cross-examination of appellant's expert, despite having been accorded the opportunity to have the hearing recessed and reconvened at a later time, as well as the questions which he asked, that neither counsel nor the Tax Commissioner was prejudiced in not being advised of the identity of appellant's expert in advance of hearing. Accordingly, for all of the foregoing reasons, counsel's request to exclude the testimony of Dr. Buser is hereby denied.

We now turn to the merits of appellant's appeal. Simply as background, it is noted R.C. 5733.01 imposes a corporate franchise tax upon for-profit corporations for the privilege of exercising their corporate franchise. This tax is first computed on a net income basis and then on a net worth basis, with payment being determined on the higher yielding tax. R.C. 5733.05. See *Gulf Oil Corp. v. Lindley* (1980), 61 Ohio St. 2d 23, 25.

The issue in this case is whether the gain realized by appellant on its sale of a U.S. Treasury bond should be considered when calculating its tax liability under the net income method. Relevant in this instance, R.C. 5733.04(I) provides in part:

> "'Net income' means the taxpayer's taxable income before operating loss deduction and special deductions, as required to be reported for the taxpayer's taxable year under the Internal Revenue Code, subject to the following adjustments:
>
> * * * *
>
> "(5) Deduct any interest or interest equivalent on public obligations and purchase obligations to the extent included in federal taxable income. As used in divisions (I)(5) and (6) of

this section, 'public obligations,' 'purchase obligations,' and 'interest or interest equivalent' have the same meanings as in section 5709.76 of the Revised Code.

"(6) Add any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income."

R.C. 5709.76, to which reference is made above, provides in pertinent part:

"(5) 'Public obligations' means public securities, fractionalized interests in purchase obligations, and any obligation or evidence of obligation to pay interest or interest equivalent on public securities or on fractionalized interests in purchase obligations, and does not include purchase obligations.

"(6) 'Public securities' means bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing issued by the state or a subdivision, or by any nonprofit corporation authorized to issue public securities for or on behalf of the state or a subdivision, to evidence the obligation of the state, subdivision, or nonprofit corporation to repay money borrowed by, or to pay at any future time other money obligations of, the state, subdivision, or nonprofit corporation, and does not include purchase obligations. Public securities may be in the form of either certificated securities or uncertificated securities, as those terms are defined in section 1308.01 of the Revised Code."

Appellant does not claim that the above-cited statutes specifically authorize it to deduct the gain which it realized on the sale of its U.S. Treasury bond from its net income calculation. Instead, appellant argues that Ohio's exclusion of gain realized on the sale of public obligations issued by the state or one of its political subdivisions, without similar provision being made for gain realized on the sale of federal obligations, is discriminatory and thereby violates the United States Constitution and 31 U.S.C. 3124.

Recently, in *Bd. of Edn. of the City of Dublin School Dist. v. Tracy* (Feb. 14, 1996), B.T.A. Case No. 95-K-692, this Board reviewed its role when challenges of a constitutional nature are made. Citing several decisions of the Ohio Supreme Court, we once again acknowledged the well-settled principle that the Board of Tax Appeals, a statutorily created administrative agency, is without jurisdiction to declare a given statute unconstitutional. *Id.* at 5-6. In this same decision, we also concluded that the Board of Tax Appeals is without authority to address constitutional challenges regarding the application of a statute to a given set of facts:

> "[G]iven the more recent decision in *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St. 3d 195, we conclude that the ability to determine whether a statute has been applied in a manner which is unconstitutional is reserved for courts created by Article IV, Section 1, of the Ohio Constitution. When MCI appealed to this Board, it claimed that the Tax Commissioner's application of one statute to it rather than another denied MCI of equal protection of the laws. See *MCI Telecommunications, Corp. v. Limbach* (Jun. 12, 1992), B.T.A. Case No. 88-G-1137, unreported, at 3 (quoting notice of appeal paragraphs four and five). In reserving ruling on these issues, we stated:
>
> "'Further, although this Board received the testimony and evidence relative to the constitutional issues raised, the parties did not brief the issues since the Board of Tax Appeals lacks jurisdiction to decide the issues. * * * Therefore, the only remaining issue presented for resolution is whether the Tax Commissioner properly apportioned the taxable value of MCI's taxable property among the taxing districts in Ohio.' *Id.* at 3-4. (Citation omitted.)
>
> "On appeal, the Supreme Court agreed with the foregoing, holding as follows:
>
> "'The BTA understood its role to be a receiver of evidence for constitutional challenges. Accordingly, it did so, giving the parties wide latitude in presenting the evidence. The BTA

determined no facts on the constitutional questions. The commissioner, however, in her Proposition of Law No. IV, contends that the BTA not only receives evidence in this type of case, but must weigh the evidence and determine the facts necessary for the court's review of the constitutional questions. Since the BTA did not make findings of fact, the commissioner asserts that we should remand the case for the BTA to comply.

"In *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St. 3d 229, * * *, paragraph three of the syllabus, we held:

"'"The question of whether a tax statute is unconstitutional when applied to a particular state of facts must be raised in the notice of appeal to the Board of Tax Appeals, and the Board of Tax Appeals must receive evidence concerning the question if presented, even though the Board of Tax Appeals may not declare the statute unconstitutional. (*Bd. of Edn. of SouthWestern City Schools v. Kinney* [1986], 24 Ohio St. 3d 184, * * * construed.)"

"'We explained the process, 35 Ohio St. 3d at 232 * * *:

"'"When a statute is challenged on the basis that it is unconstitutional in its application, this court needs a record, and the proponent of the constitutionality of the statute needs notice and an opportunity to offer testimony supporting his or her view.

"'"To accommodate this court's need for extrinsic facts and to provide a forum where such evidence may be received and all parties are apprised of the undertaking, it is reasonable that the BTA be that forum. The BTA is statutorily created to receive evidence in its role as factfinder."

"'Under *Cleveland Gear*, the BTA need only receive evidence for us to make the constitutional finding. This is because the BTA accepts facts but cannot rule on the question. On the other hand, we can decide the constitutional questions but have limited ability to receive evidence. Thus, the BTA receives evidence at its hearing, but we determine the facts necessary

to resolve the constitutional question.' *MCI Telecommunications*, *supra*, 68 Ohio St. 3d at 197-198. (Parallel citations omitted.)" *Id.* at 7-9.

The issue which is presented by appellant's appeal and, in turn, the relief which it requests is beyond the jurisdiction of the Board of Tax Appeals. The applicable statutory provisions do not specifically provide for the exclusion of gain realized on the sale of federal obligations in the calculation of a corporation's tax base under the net income method prescribed by R.C. 5733.05. Accordingly, it is the decision of the Board of Tax Appeals that appellant's specification of error must be overruled. It is therefore the order of this Board that the final determination of the Tax Commissioner must be, and hereby is, affirmed.

I hereby certify the foregoing to be a true and correct copy of the action of the Board of Tax Appeals of the State of Ohio, this day taken, with respect to the above matter.

/s/ Kiehner Johnson
Kiehner Johnson, Chairman

Supreme Court, U.S.
FILED
DEC 24 1997
CLERK

(2)

No. 97-868

In the Supreme Court of the United States

OCTOBER TERM, 1997

NACCO INDUSTRIES, INC., PETITIONER

v.

ROGER W. TRACY, OHIO TAX COMMISSIONER

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF OHIO

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

SETH P. WAXMAN
Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
ERNEST J. BROWN
DAVID ENGLISH CARMACK
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

16 pp

QUESTION PRESENTED

Whether Ohio impermissibly discriminates against holders of federal obligations by requiring gains from the sales of United States bonds to be included in state taxable income while excluding from tax gains from sales of Ohio state and local bonds.

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In the Supreme Court of the United States

OCTOBER TERM, 1997

NACCO INDUSTRIES, INC., PETITIONER

v.

ROGER W. TRACY, OHIO TAX COMMISSIONER

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF OHIO

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

Substantial amounts of United States bonds are owned by taxpayers who reside in Ohio and who are subject to the tax laws of that State. In this case, the Ohio Supreme Court upheld the imposition of a state tax on gains realized from sales of United States bonds even though the tax is not imposed on gains realized from sales of Ohio state and local bonds. This discrimination in treatment between holders of federal obligations and holders of state obligations violates the intergovernmental immunity doctrine of the Constitution. The United States markets its securities throughout the Nation and has an important interest in assuring that the holders of its obligations are not subject to discriminatory state taxation.

STATEMENT

1. In 1982, petitioner paid $6,100,003 to purchase a fifteen-year U.S. Treasury Bond with a principal amount of $8,000,000 (Pet. App. 1a). Because this bond was backed by the full faith and credit of the United States government, petitioner was certain to realize a gain of $1,899,997 if the bond were held to maturity.[1] Petitioner could have incurred a loss from ownership of the bond only if interest rates increased after the date the bond was acquired *and* the bond was sold before it reached maturity.

Petitioner sold the bond in 1989 for $7,694,071. The sales proceeds included (i) a return of petitioner's investment of $6,100,003, (ii) accrued but unpaid interest on the bond in the amount of $126,575 and (iii) a realized gain from ownership of the bond in the amount of $1,467,493 (Pet. App. 1a).

2. Ohio imposes a corporate franchise tax that is computed on both a net worth and net income basis. Corporations are to pay "whichever produces the

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[1] The discount that petitioner paid from the face value of the bond was not "original issue discount" of the type that is treated as imputed interest income under the Internal Revenue Code. See 26 U.S.C. 1271-1275. The discount instead resulted from the operation of ordinary economic principles on the fact that market interest rates increased between the time that the bond was first issued and the time that it was purchased by petitioner. The difference between the purchase price of the bond and the price at which it was sold would therefore ordinarily be treated as a capital gain under the Internal Revenue Code. See 26 U.S.C. 1001(a). The fact that the gain was certain to occur if the bond had been held to maturity, however, makes the enhanced value obtainable from holding the bond to maturity analogous to additional interest payments on the bond.

greater tax" (Pet. App. 2a). In calculating the tax due on the net income basis, "[t]he initial base * * * is federal taxable income" (*ibid.*). From that initial base, corporations are permitted to "[a]dd any loss or deduct any gain resulting from the sale, exchange, or other disposition" of Ohio state and local bonds (*ibid.*, quoting Ohio Rev. Code Ann. § 5733.04(I)(6) (Anderson 1996)). Ohio law does not, however, permit a similar adjustment for the gains included in federal taxable income that are attributable to the sale, exchange or other disposition of United States bonds. As the Ohio Supreme Court recognized in this case, the result is that the "gain from the sale of an Ohio obligation is exempt from the Ohio franchise tax, while gain from the sale of a federal obligation is not" (Pet. App. 2a).

3. In reporting taxable income on its Ohio return for 1990, petitioner did not include the $1,467,493 gain that it realized that year from the sale of the federal bond. Petitioner asserted that the state tax statute violated the constitutional intergovernmental immunity doctrine, and 31 U.S.C. 3124(a), by discriminatorily imposing a tax on the gain from the sale of federal bonds while exempting from tax any similar gain on state bonds.[2] The Tax Commissioner of Ohio

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[2] 31 U.S.C. 3124(a) provides that:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except—
>
> (1) a nondiscriminatory franchise tax or another non-property tax instead of a franchise tax, imposed on a corporation; and

rejected petitioner's claim. The Ohio Board of Tax Appeals affirmed, noting that it lacked jurisdiction to consider any constitutional objections to the state tax (Pet. App. 12a-20a).

4. The Ohio Supreme Court affirmed (Pet. App. 1a-11a). The court first rejected the contention that the state tax violates 31 U.S.C. 3124(a). That statute generally prohibits state taxation "that would require the [federal] obligation, the interest on the [federal] obligation, or both, to be considered in computing a tax" (31 U.S.C. 3124(a)). The court concluded that this statute does not apply to the Ohio tax because the value of the federal bonds did not have to be considered in computing the tax (Pet. App. 5a). The court reasoned that the gain taxed by Ohio is determined by comparing the purchase and sale prices of petitioner's private transactions, not by considering the "obligation" of the United States under the bonds (*ibid.*).

In concluding that 31 U.S.C. 3124(a) is inapplicable to the challenged state tax, the court also relied on the difference in the language of that statute and 31 U.S.C. 3124(b). The court noted that 31 U.S.C. 3124(a)—which precludes various types of state taxation of federal obligations—makes no explicit reference to gains from transactions in federal obligations; by contrast, 31 U.S.C. 3124(b)—which provides for federal taxation of federal obligations—contains an explicit reference to gains from transactions in such obligations. The court reasoned that Congress acted "intentionally and purposely" by including the reference to gains from such transactions in one subsection while omitting it in the other (Pet. App. 4a,

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(2) an estate or inheritance tax.

quoting *City of Chicago* v. *Environmental Defense Fund*, 511 U.S. 328, 338 (1994)). The court concluded that, if Congress had "intended Section 3124(a) immunity to extend to gains from the sale of federal obligations, it would have expressed that intent in the statute" (Pet. App. 5a).

The Ohio Supreme Court further held that the Ohio statute does not unconstitutionally discriminate against the holders of federal obligations (Pet. App. 6a-11a). The court stated that a state tax that discriminates against the holders of federal obligations does not violate the Supremacy Clause if Congress has authorized the discrimination (Pet. App. 9a). The court held that by expressly precluding the States from imposing taxes on the principal or interest received from federal bonds under 31 U.S.C. 3124(a)—and not expressly precluding state taxation of gains realized from the sales of such bonds—Congress implicitly authorized the States to discriminate in their tax treatment of the latter (Pet. App. 9a).

The court further held that, even if it "must consider whether the tax is discriminatory," the Ohio tax would be valid (Pet. App. 9a). The court noted that an expert witness had testified at trial that "exclusion of gain from the sale of state obligations but not federal obligations would place federal obligations at a disadvantage in the market" (*id.* at 10a). The court stated, however, that the Ohio statute (by incorporating federal taxable income) permits *losses*, as well as gains, from sales of federal bonds to be considered in computing the state tax (*ibid.*). The court stressed that the expert witness had not expressed "an opinion on the relative marketability of the obligations when accounting for both gains and losses from the sale of federal obligations but not on state obligations"

(*ibid.*). The court stated that it was therefore "mere conjecture or speculation" whether Ohio's discriminatory treatment of holders of federal obligations affected "the relative marketability" of federal bonds (*ibid.*). The court held that such "speculation" could not support a conclusion that the Ohio statute violates the Constitution (*id.* at 11a).

ARGUMENT

1. The Ohio franchise tax unconstitutionally discriminates against the holders of federal obligations.[3] "A state tax that imposes a greater burden on holders of federal property than on holders of similar state property impermissibly discriminates against federal obligations." *Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. 392, 397 (1983). See also *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744 (1961); *Schuylkill Trust Co.* v. *Pennsylvania*, 296 U.S. 113 (1935).[4] By

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[3] The existence of "discrimination" in the state tax scheme is a required element for both the constitutional and statutory theories urged by petitioner. A state tax that falls within the scope of 31 U.S.C. 3124(a) is not invalid if it is "a nondiscriminatory franchise tax * * * imposed on a corporation" (*ibid.*). In cases in which the statutory and constitutional prohibitions both turn on the existence of discrimination, this Court has focussed on the extensive constitutional precedent that elaborates the nondiscrimination requirement. See, *e.g.*, *Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. 392, 397 (1983); *New Jersey Realty Title Ins. Co.* v. *Division of Tax Appeals*, 338 U.S. 665, 672 (1950). The Court's decisions "have treated [the statute] as principally a restatement of the constitutional rule." *Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. at 397. We therefore address only the constitutional issue in this brief.

[4] "[I]t still remains true, as it has from the time of *M'Culloch* v. *Maryland*, 4 Wheat. 316, that a state tax may not discriminate against the Government or those with whom it

taxing gains realized from sales of federal obligations but exempting similar gains realized from sales of state obligations, the Ohio tax "imposes a greater burden on holders of federal property than on holders of similar state property" and thus "impermissibly discriminates" against federal obligations (*Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. at 397).

a. The Ohio Supreme Court erred in concluding that, to establish the existence of discriminatory state taxation, the taxpayer has the burden of showing that the tax actually hinders the marketing of federal securities (Pet. App. 10a). The decisions of this Court do not support that proposition.

The Ohio Supreme Court noted that, in *Willcuts* v. *Bunn*, 282 U.S. 216 (1931), this Court stated that a tax on gains from the sale of government bonds does not necessarily disadvantage the marketing of such bonds if "there is also a deduction for losses on sales" (Pet. App. 8a, quoting 282 U.S. at 231). In upholding application of the federal income tax to gains realized from sales of state bonds in *Willcuts*, the Court rejected the assertion that such a tax unconstitutionally interfered with "a function of government" (Pet. App. 11a). The Court emphasized, however, that the federal tax involved in *Willcuts* was "nondiscriminatory" because it applied equally to gains from sales of federal and state bonds. 282 U.S. at 227. In upholding such nondiscriminatory taxation, the Court did not suggest in *Willcuts* that the victims of *discriminatory* taxation would be required to establish that the tax adversely "affects a function of

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deals." *Phillips Chemical Co.* v. *Dumas Independent School District*, 361 U.S. 376, 387 (1960).

government" (Pet. App. 11a), as the court erroneously held in this case.[5]

The Ohio Supreme Court also erred in relying (Pet. App. 10a) on *Rockford Life Insurance Co.* v. *Illinois Department of Revenue*, 482 U.S. 182 (1987). In that case, this Court upheld application of a nondiscriminatory state property tax to bonds that were issued by private institutions and guaranteed by the United States. The Court stated that the possibility that the United States would have to honor its guarantee was too speculative to warrant the conclusion that such bonds were "obligations" of the United States to which constitutional immunity attaches. *Id.* at 190. That holding does not support the conclusion of the court below that the evidence in this case is insufficient "speculation" (Pet. App. 10a) to support a finding of discrimination.

b. Indeed, the Ohio Supreme Court acknowledged that the evidence in this case establishes that the state tax on gains realized on federal bonds, and its

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[5] The question whether a state tax "discriminates against federal obligations" (*Nebraska Dep't of Revenue* v. *Loewenstein*, 513 U.S. 123, 135 (1994)) is separate from the question whether the state tax violates "the intergovernmental tax immunity doctrine" by "taxing federal obligations in a manner which has an adverse effect on the United States' borrowing ability" (*id.* at 136). In *Loewenstein*, the Court rejected a claim of discrimination because the State treated income derived from state and local obligations no differently than it treated income derived from federal obligations. *Id.* at 135-136. The Court then rejected the further claim that the state tax unconstitutionally interfered with "the borrowing power" of the United States because there was "no evidence in the record that the taxation at issue will impair the market in federal securities or otherwise impair the borrowing ability of the Federal Government." *Id.* at 137.

exemption for gains realized on state bonds, discriminates against holders of federal bonds (Pet. App. 10a). Nothing about that evidence involves "mere conjecture or speculation" (*ibid.*). What *is* merely "conjecture or speculation," however, is the state court's suggestion that a compensating benefit to the holders of federal bonds *might* occur because state law permits losses on sales of federal bonds to be recognized under the state tax but does not allow losses on sales of state bonds to be so recognized.

In the first place, there is no authority for the court's proposition that an established discrimination against a holder of federal property may be permitted because of the speculative possibility that a compensating advantage might exist elsewhere in the state tax scheme in some other year or for some other holder of federal property. Such an unmanageable proposition has never been adopted by this Court. Indeed, as petitioner notes (Pet. 19-20), similar propositions have been rejected by the Court in analogous constitutional contexts involving state taxation.

Moreover, the Ohio Supreme Court erred in assuming that a state taxpayer would, by incorporating federal taxable income under the state statute, obtain a compensating advantage from any "losses" realized from sales of federal bonds. Net losses from the sales of government bonds would not be a component of federal taxable income for corporate taxpayers because the Internal Revenue Code specifies that, "[i]n the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges" (26

U.S.C. 1211(a)).[6] The concept of federal taxable income that is incorporated for state tax purposes under Ohio law thus may include a net gain from transactions in capital assets but, under 26 U.S.C. 1211(a), it will not include a net loss. The Ohio Supreme Court thus erred in concluding that a taxpayer would, by incorporating federal taxable income under the state statute, obtain an advantage from net losses that could offset the disadvantage incurred by discriminatory state taxation of net gains on the sales of federal bonds.

Both for corporate and individual taxpayers (see note 6, *supra*), the state tax discriminates directly against the holders of federal bonds by requiring inclusion of gains on sales of federal bonds while excluding gains on state bonds. There is no compensating advantage "when accounting for both gains and losses" (Pet. App. 10a). Even if it were conceptually possible for a State to justify discriminatory treatment of federal obligations by some compensating advantage otherwise provided under state law—a conclusion that this Court has never reached—the State has not sustained its burden of doing so on the record of this case.[7]

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[6] Losses from such transactions for corporations may be carried back three years and carried forward five years to be offset against gains in other periods. 26 U.S.C. 1212(a). A net loss is not reflected in federal taxable income, however, for any period. By contrast, individuals may report a net loss from such transactions, but only up to the amount of $3000 in any year. 26 U.S.C. 1211(b).

[7] For the reasons summarized by petitioner (Pet. 14-15), the Ohio Supreme Court plainly erred in suggesting (Pet. App. 9a) that, in enacting 31 U.S.C. 3124(a), Congress implicitly author-

2. The decision of the Ohio Supreme Court in this case is of broad recurring importance. Other States either have imposed, or could impose, similar tax schemes that advantage their own obligations by disadvantaging those of the United States. See Pet. 20. In holding a similar state tax provision unconstitutional, the Maryland Court of Special Appeals recognized that taxing gains from federal obligations while exempting gains from state obligations "diminish[es] the investment attractiveness of the United States obligations in favor of state obligations." *Doneski* v. *Comptroller*, 605 A.2d 649, 653 (1992), cert. denied, 506 U.S. 1054 (1993). A state tax that discriminates against the holders of federal bonds interferes with the extraordinarily important federal function of marketing trillions of dollars of United States obligations. Review by this Court is warranted to ensure that States are not permitted to favor their own obligations by discriminating against those of the National government.

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ized discriminatory state taxation of gains from sales of federal securities.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
ERNEST J. BROWN
DAVID ENGLISH CARMACK
Attorneys

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No. 97-868

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

NACCO Industries, Inc.,
Petitioner,

v.

ROGER W. TRACY, TAX COMMISSIONER OF OHIO,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Ohio

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RESPONDENT'S BRIEF IN OPPOSITION

BETTY D. MONTGOMERY
Attorney General of Ohio
SIMON B. KARAS
Deputy Chief Counsel
RICHARD C. FARRIN
(Counsel of Record)
ELISE W. PORTER
Assistant Attorneys General
30 East Broad Street, 16th Floor
Columbus, Ohio 43215-3428
(614) 466-5967

COUNSEL FOR RESPONDENT

QUESTIONS PRESENTED

Ohio's Corporate Franchise Tax considers both gains and losses on the sale of federal obligations but excludes from consideration both gains and losses on the sale of state obligations in the calculation of net income base. This case presents the following questions:

1. Whether the above provisions of Ohio's corporate franchise tax violate 31 U.S.C. §3124(a). .

2. Whether Congress has comprehensively defined the scope of immunity for federal obligations from state taxation in the enactment of 31 U.S.C. §3124(a).

3. Whether the factual finding by the Ohio Supreme Court that NACCO failed to establish that the challenged franchise tax provisions discriminated against federal obligations was without evidence to support it.

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STATEMENT

In its petition, NACCO mischaracterizes both the decision by the Ohio Supreme Court and the challenged franchise tax provisions, to argue that a substantial federal question is presented. A fair reading of the decision and statute however establishes no case worthy of certiorari review. No conflict exists with state or lower appellate court rulings, and no conflict exists with decisions of this Court, or the statutory scheme involved. No national issue of importance is presented; only three states are identified as having a similar taxation method.

Most notably for purposes of this Court's consideration of whether to grant the petition, the Ohio Supreme Court held that NACCO had "failed to establish that the franchise tax discriminates against the federal government or those with whom it deals." App. 11a. The Ohio Supreme Court so held on the basis of the testimony of NACCO's own expert witness regarding the effect of the entire statutory provision which considers not only gains but also losses from sales of state and federal obligations.

Additionally, applying the plain language of 31 U.S.C. §3124(a), the court held that the immunity granted by Congress extended only to state taxation which would require the federal obligation or the interest on the federal obligation to be considered in the computation of the tax. App. 4a. Contrary to NACCO's statement, the court did not so hold because it determined that its construction of section 3124(a) was compelled by this Court's decision in *Nebraska Department of Revenue v. Lowenstein*, 513 U.S. 123 (1994). Instead, the Ohio Supreme Court determined that its holding was compelled by the plain language of the statute, noting that it expressly referred only to federal obligations and the interest on such obligations, and contained no reference to gains on the sale of such obligations.

Finally, the Ohio Supreme Court simply followed the heedings of this Court that when Congress has acted in the area of intergovernmental immunity by establishing an exemption from state taxation or regulation a court should give substantial deference to Congress and not expand such immunity beyond that clearly established by Congress. See *North Dakota v. United States*, 495 U.S. 423, 435 (1990); *Rockford Life Insurance Co. v. Illinois Dept. of Revenue*, 482 U.S. 182, 191-192 (1987); *Washington v. United States*, 460 U.S. 536, 546 (1983); *United States v. Detroit*, 355 U.S. 466, 474-475 (1958). As a result, the Ohio Supreme Court held that the Ohio franchise tax provisions which considered both gains and losses on the sale of federal obligations in the net income base measure but excluded consideration of both gains and losses on the sale of state obligations in that measure did not violate that doctrine.

REASONS THE PETITION SHOULD BE DENIED

This case does not present any issues which warrant review by this Court. It is simply a case involving one taxpayer's challenge to a $116,202.58 franchise tax imposed pursuant to a state tax provision which the taxpayer asserted but failed to establish discriminated against federal obligations. The decision below by the Ohio Supreme Court is not in conflict with any decisions of other state courts of last resort, United States Courts of appeal, or this Court. Nor is the decision below in conflict with the provisions of 31 U.S.C. §3124.

A. The Decision Below Does Not Present A Substantial Federal Question; Instead It Involves The Failure By NACCO To Present Evidence Establishing Its Claim Of Discrimination.

This case does not present a substantial federal question that demands this Court's review. Instead, it involves the application by the Ohio Supreme Court of the plain language of a federal statute, 31 U.S.C. §3124(a), by which Congress comprehensively declared the scope of immunity from state taxation provided federal obligations, and the established precedents of this Court regarding intergovernmental immunity. Ultimately, it involves a factual determination by the Ohio Supreme Court that the evidence failed to establish that the challenged statutory scheme discriminated against the federal government or those with whom it deals. As a result of this factual finding, NACCO's challenge to the franchise tax would have been rejected even if all of its legal arguments regarding the scope of the statutory and constitutional immunity provided to federal obligations were accepted. For this reason alone, this case does not merit review by this Court.

In the context of federal obligations, this Court has stated the nondiscrimination rule as follows:

> . . . a tax generally does not violate the constitutional immunity if it does not discriminate against holders of federal property or those with whom the Federal Government deals.

Memphis Bank & Trust Co. v. Garner, 459 U.S. 392,397.

Moreover, because the nondiscrimination rule of the intergovernmental immunity doctrine is based upon the principle that the states cannot obstruct the activities of the federal government, *North Dakota v. United States*, 495 U.S., at 437-438, in considering NACCO's discrimination claim the Ohio Supreme Court properly focused on the effect of the challenged franchise tax provisions on the activity of the federal government involved - the exercise of the borrowing power through the sale of federal obligations. App. 9a - 10a.

Based upon the evidence, the Ohio Supreme Court held that NACCO had failed to establish that the challenged tax provisions effected a discrimination against federal obligations. Presented with the undisputed fact that under the Ohio franchise tax provisions both gains and losses from the sale of federal obligations are considered in computing the net income base while neither gains nor losses from the sale of state obligations are considered in the computation, NACCO's expert witness testified that he could not give an opinion on whether such a scheme would have an effect on the marketability of federal obligations or, if it would, whether the effect would be a positive or a negative one.[1] NACCO's expert could not give such an opinion because while the exclusion of gain from the sale of state obligations

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[1] Unlike NACCO, the Ohio Supreme Court observed this Court's admonitions that a state tax scheme is not discriminatory simply because it treats those who deal with the federal government differently, and that a determination whether a tax is discriminatory must be based upon a review of the whole tax structure. *Washington v. United States*, 460 U.S., at 542. Throughout its argument, NACCO consciously focuses solely on that part of the franchise tax provision that deals with gain, and ignores that part that deals with losses.

but not federal obligations would, in his opinion, place some disadvantage on federal obligations in the marketplace, the required add back of losses from the sale of state obligations but not federal obligations would, in his opinion, have the reverse effect - it would place federal obligations at an advantage in the market, a fact which NACCO studiously ignores.

B. The Decision Below Does Not Conflict With The Decision Of Another State Court Of Last Resort Or A United States Court Of Appeals.

The decision of the Ohio Supreme Court is not in conflict with the decision of another state court of last resort or a United States court of appeals. The only decision which NACCO portrays as in conflict with the decision of the Ohio Supreme Court is *Doneski v. Comptroller of the Treasury*, 605 A. 2d 649 (Md. Ct. Spec. App. 1992), *cert. denied* 506 U.S. 1054 (1993). That lone decision is not a sufficient reason to grant review.

Initially, that decision was issued by an intermediate state court of appeals, the Maryland Special Court of Appeals. Moreover, the decision simply does not present a conflict. *Doneski* involved the imposition of Maryland's personal income tax on gains from the sale of federal obligations. More importantly, the statutory scheme under review in *Doneski* did not include a provision requiring that losses on the sale of state obligations be added back to the base on which the income tax was imposed. Thus, the scheme was materially different than the Ohio franchise tax provisions at issue herein. That is, perhaps, the reason that the state did not address the issue of discrimination in *Doneski*.

C. The Decision Below Does Not Conflict With The Decisions Of This Court.

1. The Decision Below Did Not Misinterpret *Nebraska Department of Revenue v. Lowenstein*, 513 U.S. 123 (1994).

NACCO states that the Ohio Supreme Court rejected its argument that the franchise tax provisions violate 31 U.S.C. §3124 because the court believed that *Nebraska Department of Revenue v. Lowenstein*, *supra*, compelled its construction of that statute (Pet. At 8), and then proceeds to urge this Court to grant certiorari to correct what NACCO claims was a fundamental misinterpretation of *Lowenstein* by the Ohio Supreme Court. The basic flaw in this argument is that it is based upon an erroneous premise. NACCO grossly overstates the reliance placed on *Lowenstein* by the Ohio Supreme Court. That court did not state or even imply that its construction of section 3124(a) was compelled by *Lowenstein*.

Clearly, *Lowenstein* was cited by the Ohio Supreme Court simply to note that like the transaction generating the income in *Lowenstein*, the transaction in this case - the sale of federal obligations from the purchaser, NACCO, to a private party - was one between private parties; the income was not, therefore, attributable to the contractual relationship between NACCO and the federal government arising out of NACCO's purchase of the federal obligations from the federal government. This distinction between transactions whereby the owner of a government obligation sells it to a private party and those for the purchase of the obligation from the government in which the government contracts to pay interest was the very same distinction relied on in

Willcuts v. Bunn, 282 U.S. 216, 227 (1931), as the basis for rejecting an intergovernmental immunity challenge to a federal tax imposed on gains from the sale of state obligations.[2]

In any event, the Ohio Supreme Court held that section 3124(a) did not extend immunity to gains from the sale of federal obligations, not because it felt that such a construction was compelled by *Lowenstein*, but by the clear language of the statute. App. 4a.

2. The Decision Below Does Not Conflict With *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983).

Memphis Bank & Trust Co. is inapposite because the challenged state tax was imposed on interest on federal obligations, not on gains from the sale of such obligations. That case involved a challenge under 31 U.S.C §742 (replaced without substantive change by 31 U.S.C. §3124(a)) to a Tennessee bank tax imposed on net earnings of banks, including interest received on federal obligations but not interest received on Tennessee obligations. 31 U.S.C. §742 was clearly applicable because it (like its successor, section 3124(a)) expressly included within its scope every form of state taxation that would require interest on federal obligations to be considered. The specific issue in *Memphis*

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[2] Although *Willcuts* involved a federal tax imposed on the gain from the sale of state obligations, the same reasoning was applied to both federal and state tax immunity. See, *e.g.*, *South Carolina v. Baker*, 485 U.S. 505, 518 (1988).

Bank & Trust Co. was not whether the tax fell within the scope of the statute, but whether it fell within the exception for nondiscriminatory franchise taxes set forth in the statute.

Memphis Bank & Trust Co. was decided solely under the statute. The statute does not, however, include gains from the sale of federal obligations within its scope. As a result, the statute, including the nondiscrimination provision, is inapplicable. Therefore, *Memphis Bank & Trust Co.* is wholly inapposite.

D. The Decision Below Does Not Conflict With The Language Of 31 U.S.C. §3124(a).

A review of 31 U.S.C. §3124(a) demonstrates that the holding by the Ohio Supreme Court that the franchise tax provisions do not violate that statute is unassailable:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except --
>
> > (1) a nondiscriminatory franchise tax or another non property tax instead of a franchise tax, imposed on a corporation; and
> >
> > (2) an estate or inheritance tax.

Contrary to NACCO's assertion, section 3124(a) does not extend the exemption from state taxation to gains realized from the sale of federal obligations. By the plain language

of the statute, the exemption is extended to "the obligation" and "the interest on the obligation." It contains no mention of gains.

Had Congress intended the exemption to extend to gains from the sale of federal obligations it would have expressly so provided. See *California State Bd. of Equalization v. Sierra Summit, Inc.*, 490 U.S. 844, 854 (1989). Interest on an investment is clearly understood as a distinct item from gain realized from a sale of that investment. This distinction between interest and gain was the basis of the ruling in *Willcuts v. Bunn*, 282 U.S., at 227, upholding against an intergovernmental immunity challenge a federal tax imposed on the gain from the sale of state obligations.

Further demonstrative of the lack of substance in NACCO's assertion is the fact that in former 31 U.S.C. §742 and §742a, as amended in 1959 by Publ. L. 86-346, 73 Stat. 622, 624, Congress included only the language "obligations or the interest thereon" in defining the scope of the exemption from state taxation (§742), but included not only "interest upon" but also "gains from the sale" of federal obligations in the immediately following section (§742a) which dealt with federal taxation. The same is true in current 31 U.S.C. §3124(a) and (b). Subsection (a), which deals with state taxation, refers only to interest while subsection (b), which deals with federal taxation, refers not only to interest but also to earnings and other income and to gain from the sale of federal obligations.

The legislative history of the 1959 amendment to Rev. Stat. §3701, as so amended, 31 U.S.C. §742 (86th Congress, H.R. 9035) further evidences that Congress expressly referenced gains when it intended that they be included within the scope of the provision. Part II.D. of the Senate

report, which explained the section of the bill regarding the exemption from state taxation, referred only to interest; it contains no mention of gains. U.S. Cong. & Adm. News, 86th Congress, 1st Session 1959 (2), 2769, 2773-4. The immediately following part of the Senate report (II.E.), discussed a section of the bill which provided for the nonrecognition of gain or loss on certain exchanges of United States obligations for new United States obligations. *Id.* at 2774. This demonstrates that Congress was fully cognizant of the separate concepts of interest and gains when they amended Rev. Stat. §3701, because in the very same bill Congress addressed and amended another statute which dealt specifically with the treatment of gains from federal obligations. Given Congress' obvious awareness of this distinction, the absence of any inclusion of "gain" in Rev. Stat §3701 can only be presumed to be intentional. *Chicago v. Environmental Defense Fund*, 511 U.S. 328, 338 (1994), citing *Keene Corp. v. United States*, 508 U.S. 200 (1993). Accord, *Rodriquez v. United States*, 480 U.S. 522, 525 (1987).

Congress has not expressed any intent to include gains from the sale of federal obligations within the comprehensive grant of immunity from state taxation provided by 31 U.S.C. §3124(a). The specific language used by Congress does not even imply such an intent. This clearly expressed intent should not be expanded or modified by the courts. *Rockford Life Insurance Co. v. Illinois Dept. of Revenue*, 482 U.S., at 191-192; *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 479 (1939). As *Rockford Life Insurance* cautions:

> A court must proceed carefully when asked to recognize an exemption from state

> taxation that Congress has not clearly established.

482 U.S., at 191.

NACCO attempts to avoid the fatal impact of the absence of any reference to gain in section 3124(a) by engaging in a tortured construction of the language in that provision. NACCO argues that a tax which considers gains on the sale of federal obligations in its computation is a tax which considers the obligation in its computation. On its face, this argument is fallacious. A tax which considers the gain does just that, it does not consider the obligation in the computation.

NACCO's construction is also rebutted by the very language relied upon. That language states that a tax falls within the exemption if it requires the obligation or the interest on the obligation to be considered. Under NACCO's construction, there would be no reason to include interest within the provision because if the general reference to obligations included a prohibition on considering gain it would certainly prohibit a consideration of interest. The separate inclusion of interest in the language of the provision conclusively negates any argument that the term "obligation" was intended to include anything other than the principal of the obligation.

Thus, the absence of any prohibition on the inclusion or consideration of gains from the sale of federal obligations is not at all puzzling. As *Willcuts v. Bunn*, 282 U.S., at 232, noted, the taxation by states of gains on the sale of federal obligations had not historically been a concern of the federal government. It is not a concern of section 3124(a).

E. No Question Of National Importance Is Presented; Any Concerns Portended By NACCO Regarding The Marketability Of Federal Obligations Can Best Be Addressed By Congress.

NACCO asserts that a substantial national question is presented, but cites to only two other states that have a similar taxation methodology to Ohio. And this case involves only one taxpayer, seeking approximately $116,000. If this were ever a proper issue for certiorari, it is one that needs further development before it is worthy of this Court's review.

NACCO's argument that this case presents issues that have serious implications for the ability of the federal government to borrow money through the sale of its obligations (Pet. at 20-21) is based wholly upon assertions that are simply in conflict with the evidence. As detailed earlier, NACCO's own expert witness could not testify that the challenged franchise tax provisions would place federal obligations at a market disadvantage. Dr. Buser admitted that he could not give an opinion as to whether the difference in the treatment of gains and losses from the sale of federal as opposed to state obligations would make federal obligations more attractive or less attractive to an investor. NACCO's statement that the federal government would have to offer higher interest rates is likewise unsupported because it is based solely upon the erroneous assertion of a demonstrated market disadvantage for federal obligations.

In all events, NACCO's claims of adverse consequences to the ability of the federal government to market its obligations ignores a fundamental fact. If Congress determines that such statutory schemes would burden or obstruct the federal government's ability to market

federal obligations, it has the unquestioned power to alleviate any such concern by the simple expedient of amending section 3124(a) to prohibit the consideration of gains from the sale of federal obligations under such statutory schemes.

Moreover, in the absence of a mandate in the Constitution or in section 3124(a), it should be left to Congress to address any perceived adverse consequences regarding the marketability of federal obligations. As this Court has noted, deference should be given to Congress to determine the scope of intergovernmental immunity because Congress is best qualified to resolve the delicate balancing of the competing demands of the respective governments. *North Dakota v. United States*, 495 U.S., at 435; *Washington v. United States*, 460 U.S., at 546; *United States v. Detroit*, 355 U.S., at 474. Congress is in the best position to determine whether or to what extent a state tax scheme would burden or obstruct an activity of the federal government - such as the exercise of the borrowing power - and, if so, whether the situation calls for Congressional action.

CONCLUSION

For the foregoing reasons, the Court should deny the petition for a writ of certiorari.

Respectfully submitted,

BETTY D. MONTGOMERY
Ohio Attorney General
SIMON B. KARAS
Deputy Chief Counsel
RICHARD C. FARRIN
(Counsel of Record)
ELISE W. PORTER
Assistant Attorneys General
Counsel of Record
30 East Broad Street 16th Floor
Columbus, Ohio 43215-3428

COUNSEL FOR RESPONDENT

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

NACCO INDUSTRIES, INC.,
Petitioner,
v.
ROGER W. TRACY, TAX COMMISSIONER OF OHIO,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Ohio

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

JEFFREY A. FRIEDMAN
Tax Counsel
WILLIAM D. PELTZ *
BOBBY L. BURGNER
Chair and Vice Chair, Lawyers' Coordinating Subcommittee
COMMITTEE ON STATE TAXATION
122 C Street, N.W.
Suite 330
Washington, D.C. 20001
(202) 484-5222

* Counsel of Record

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Committee On State Taxation ("COST") respectfully requests leave to file a Brief as *Amicus Curiae* in support of Petitioner. The interest of COST as *amicus curiae* is described *infra* at Brief, pp. 2. Counsel for Petitioner has consented to COST's filing of an *amicus* brief. Despite COST's qualifications to submit an *amicus* brief, Counsel for Respondent has refused to consent to the filing of such a brief. However, in the absence of such permission there are at least two reasons for granting this request.

First, with respect to the Petition filed in this case, COST has additional observations to make concerning the constitutional and federal statutory implications of the interpretation of the intergovernmental tax immunity doc-

trine that has been set out by the Ohio Supreme Court in this case. A full exposition of the controversy of this case by interested and eligible *amicus* is ultimately to the benefit of the Court in its administration of writs for certiorari.

Second, because NACCO Industries, Inc. is but one of numerous COST members that are required to file returns in jurisdictions that have made conflicting interpretations of the intergovernmental tax immunity doctrine, COST is uniquely qualified to comment on the Ohio court's refusal to follow this Court's mandate to interpret the intergovernmental tax immunity doctrine as a prohibition against discrimination. *Compare Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983) *with Doneski v. Comptroller of the Treasury,* 605 A.2d 649 (Md. Ct. Spec. App. 1992), *cert. denied,* 506 U.S. 1054 (1993).

Respectfully submitted,

JEFFREY A. FRIEDMAN
Tax Counsel
WILLIAM D. PELTZ *
BOBBY L. BURGNER
Chair and Vice Chair, Lawyers' Coordinating Subcommittee
COMMITTEE ON STATE TAXATION
122 C Street, N.W.
Suite 330
Washington, D.C. 20001
(202) 484-5222

* Counsel of Record

December 22, 1997

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BRIEF OF COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee On State Taxation as *amicus curiae* in support of the Petitioner in the above-captioned matter.*

---

* No Counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae*, its members or counsel, has made a monetary contribution to the preparation or submission of this brief. NACCO Industries, Inc., a COST member, has reimbursed COST for printing expenses associated with preparing this *amicus curiae* brief.

INTEREST OF *AMICUS CURIAE*

The Committee On State Taxation ("COST") is a non-profit trade association that was organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incorporated on January 1, 1992, has a membership of over 460 multistate corporations, including NACCO Industries, Inc., engaged in interstate and international commerce. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities.

Many of COST's members are engaged in business in the State of Ohio, and thus have a particular interest in the ultimate resolution of the method by which the Ohio corporate franchise tax is calculated and imposed. Further, the Ohio Supreme Court's narrow interpretation of the intergovernmental immunity doctrine is contrary to the position of at least one other State, forcing many COST members to take inconsistent tax return filing positions. *See, Doneski v. Comptroller of the Treasury,* 605 A.2d 649 (Md. 1992) *cert. denied,* 506 U.S. 1054 (1993). Therefore, COST has an interest in this case.

SUMMARY OF ARGUMENT

The Ohio Supreme Court's interpretations of both 31 U.S.C. Section 3124 and the constitutional intergovernmental tax immunity doctrine are inconsistent with this Court's decisions. The Ohio court found that the State's discriminatory taxation of the gain on the sale of federal obligations does not violate the statutory and constitutional intergovernmental tax immunity doctrines. However, this Court has made clear that such discrimination is unconstitutional. *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983). Further, holders of federal property are entitled to the doctrine's protection from discrimination. *United States v. Fresno,* 429 U.S. 452, 462 (1977).

The Ohio court, in applying the intergovernmental tax immunity doctrine, distinguished gains on federal instruments and interest earned on federal instruments and found that gains fall outside the constitutional and statutory doctrines. However, the predecessor to 31 U.S.C. Section 3124 has been construed as a "broad exemption of federal obligations from state and local taxation." *Memphis,* 459 U.S. at 395. Thus, the Ohio court's interpretation of the intergovernmental tax immunity doctrine represents another instance of a State's "hypertechnical reading of the nondiscrimination clause." *See Davis v. Michigan Dep't of Treasury,* 489 U.S. 803, 809 (1989).

ARGUMENT

THE OHIO FRANCHISE TAX DISCRIMINATES AGAINST HOLDERS OF FEDERAL INSTRUMENTS AND THEREFORE THE TAX VIOLATES THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE AND 31 U.S.C. SECTION 3124.

The scope of the intergovernmental tax immunity doctrine has evolved over the years. However, this Court has made clear that "there has been no departure from the principle that state taxes are constitutionally invalid if they discriminate against the [Federal] Government." *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 397 n.7 (1983). Further, this Court has held that "[t]he State's interest in adopting the discriminatory tax, no matter how substantial, is simply irrelevant to an inquiry into the nature of the two classes receiving inconsistent treatment," *Davis v. Michigan,* 489 U.S. 803, 816 (1989). And, "it does not follow that private entities or individuals who are subjected to discriminatory taxation on account of their dealings with a sovereign cannot themselves receive the protection of the constitutional doctrine. Indeed, all precedent is to the contrary." *Id.* at 814.

31 U.S.C. Section 3124 exempts from state and local taxation stocks and obligations of the United States. The provision does provide, however, that state and local gov-

ernments may impose a nondiscriminatory franchise or other nonproperty tax on federal obligations. 31 U.S.C. Section 3124(a)(1). In interpreting the statutory meaning of "nondiscrimination," this Court has found that the statute is "principally a restatement of the constitutional rule." *Memphis Bank & Trust v. Garner*, 459 U.S. at 396-97. Nevertheless, the Ohio Supreme Court held that 31 U.S.C. Section 3124 does not apply to gain derived from the sale of federal instruments and therefore the existence of discrimination is irrelevant: "Ohio's franchise tax is valid, *regardless of whether it is discriminatory*." *NACCO Industries, Inc. v. Tracy*, 681 N.E.2d 900, 905 (Ohio 1997) (emphasis added). The Ohio court reasoned that the intent of 31 U.S.C. Section 3124 is to immunize from state taxation only the federal obligation or interest on the obligation, and not gains from the sale of federal obligations. *Id.* at 904. Thus, because gains on the sale of federal instruments are not expressly mentioned in 31 U.S.C. Section 3124, the Court concluded that gains on the sale of federal instruments fall outside the scope of the statute.

The Ohio court extended its reading of 31 U.S.C. Section 3124 in construing the constitutional intergovernmental tax immunity doctrine. The court reasoned that under the constitutional doctrine, a franchise tax must be nondiscriminatory unless "Congress has declared otherwise." *Id.* at 905, *relying on United States v. Fresno*, 429 U.S. 452, 460 (1977). Not surprisingly, the court found that U.S.C. Section 3124 is an indication of Congress's intent to immunize from state taxation only the federal obligation or the interest on it. *Id.* at 904. Thus, the court used its interpretation of 31 U.S.C. Section 3124 to dramatically limit the reach of both the statutory and constitutional intergovernmental tax immunity doctrines.

The Ohio Supreme Court's reliance on *United States v. Fresno* is misplaced. In *Fresno*, this Court decided that the intergovernmental tax immunity clause may apply to

a property tax levied on federal employees on their possessory interests in housing owned and supplied to them by the Federal Government. 429 U.S. at 453.[1] Therefore, 31 U.S.C. Section 3124 was not relevant and was not discussed nor interpreted by the *Fresno* Court. Because the Ohio Supreme Court interpreted 31 U.S.C. Section 3124 to undermine the statutory and the constitutional intergovernmental tax immunity doctrine, the court's reliance on *Fresno* is without merit.

The Ohio court's narrow interpretation of the intergovernmental tax immunity doctrine runs contrary to this Court's prior decisions construing the statutory and constitutional intergovernmental tax immunity doctrines. In *Memphis Bank & Trust Co. v. Garner,* the Court was faced with deciding "whether the Tennessee bank tax violates the immunity of obligations of the United States from state and local taxation." 459 U.S. 392, 393 (1983). In interpreting the predecessor to 31 U.S.C. Section 3124, the Court found that "Title 31 U.S.C. Section 742 establishes a broad exemption of federal obligations from state and local taxation," 459 U.S. at 395. Thus, the lower court's finding that the interest on federal obligations is protected from discriminatory taxation, while gain on the sale of federal obligations is not, violates the Court's mandate of construing the exemption in a broad manner.

The *Memphis* decision is one of many instances where this Court has broadly interpreted the intergovernmental tax immunity doctrine. In *American Bank & Trust Co. v. Dallas,* the Court noted that an earlier version of 31 U.S.C. Section 3124 "is sweeping: with specific exceptions, it 'extends to every form of taxation that would re-

[1] The Court concluded that "[t]he tax can be invalidated, then, only if it discriminates against the [Federal Government] or other federal employees, which it does not do. *Id.* at 464. Thus, it is noteworthy that the Court's inquiry required a determination as to whether the state tax discriminated against the federal government or its employees.

quire that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax." 463 U.S. 855, 862 (1983) *relying on Memphis Bank and Trust Co. v. Garner*, 459 U.S. 392, 395-96 (1983).

While this Court has viewed the doctrine as a broad exemption from state taxation, it is unrealistic for the Court to provide guidance on every conceivable application of the doctrine. Thus, in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), the Court struck down a State's attempt to impose a discriminatory tax on the retirement benefits paid to federal retirees. The Court found that "[i]t is difficult to imagine that Congress consented to discriminatory taxation of the pensions of retired federal civil servants while refusing to permit taxation of current employees, and nothing in the statutory language or even the legislative history suggests this result." *Id.* at 810. Similarly, this Court has not had the opportunity to decide whether gains on the sale of federal instruments are constitutionally and statutorily permitted to be subjected to a discriminatory state tax, while interest on federal obligations is undoubtedly protected from such taxes. However, just as the doctrine protects the income of current employees *and* the correlative income of retired employees, the interest income from federal obligations *and* the correlative gain on the sale of federal obligations should be afforded equivalent protections.

The Ohio court found that the gain on the sale of a federal instrument "does not arise directly from the relationship between the taxpayer and the federal government. . . . We find this relationship too attenuated to invalidate the Ohio franchise tax." *NACCO*, 681 N.E.2d at 905-6. In *Memphis Bank*, the Court stated that a "tax does not violate the constitutional immunity if it does not discriminate against *holders* of federal property or those with whom the Federal Government deals." 459 U.S. at 397, (emphasis added). *See, also United States v. Fresno*, 429

U.S. 452, 462 (1977). ("A state tax that imposes a greater burden on holders of federal property than on holders of similar state property impermissibly discriminates against federal obligations."). The Ohio court's determination that the gain generated by the sale of a federal instrument by a holder of federal property falls outside of the intergovernmental tax immunity doctrine is inconsistent with this Court's prior rulings finding that owners of federal property are protected from discriminatory taxation on the ownership of federal instruments.

Finally, the Ohio court posits that because gains and losses on the sale of state instruments are not included within the Ohio franchise tax base, there is no evidence that the scheme discriminates against holders of federal instruments. *NACCO*, 681 N.E.2d at 905. The Ohio court's analysis misses the mark—the discrimination results from the fact that gains on the sale of federal obligations are taxable while gains from Ohio obligations are not. The discrimination exists at the time the instrument is purchased, and therefore, dissuades investors from purchasing federal instruments.[2] Clearly, this discrimination places holders of federal bonds at a disadvantage. The taxpayer in the present case fell victim to such discrimination and paid a higher Ohio tax than had the taxpayer sold an equivalent Ohio bond at a gain. The fact that a taxpayer could receive favorable tax treatment on the loss sale of a federal instrument vis-a-vis an Ohio instrument is irrelevant and should not save the discriminatory taxing scheme from being stricken.

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[2] As a general matter, investors make investment decisions with the intent to earn a profit. Therefore, the lower court's self serving suggestion that the disallowance of losses from State obligations negates the discriminatory treatment of gains is illusory. In *Doneski v. Comptroller of the Treasury*, 605 A.2d 649 (Md. 1992), *cert. denied*, 506 U.S. 1054, the court held that "Maryland's taxation scheme . . . impermissibly discriminates against holders of federal obligations by diminishing the investment attractiveness of the United States obligations in favor of state obligations." *Id.* at 653.

CONCLUSION

For the reasons set forth above, the Committee On State Taxation respectfully requests that the Court grant a writ of certiorari and reverse the decision of the Supreme Court of Ohio.

Respectfully submitted,

JEFFREY A. FRIEDMAN
Tax Counsel
WILLIAM D. PELTZ *
BOBBY L. BURGNER
Chair and Vice Chair, Lawyers' Coordinating Subcommittee
COMMITTEE ON STATE TAXATION
122 C Street, N.W.
Suite 330
Washington, D.C. 20001
(202) 484-5222

* Counsel of Record

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BRIEF OF THE BOND MARKET ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

PAUL SALTZMAN
SARAH M. STARKWEATHER
THE BOND MARKET ASSOCIATION
40 Broad Street
New York, NY 10004-2373

ERIKA W. NIJENHUIS
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, NY 10006-1470

December 24, 1997

CHARLES F. LETTOW
(Counsel of Record)
GIOVANNI P. PREZIOSO
ONNIG H. DOMBALAGIAN
ABBY F. RUDZIN
CLEARY, GOTTLIEB, STEEN & HAMILTON
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006-1801
(202) 974-1500
Counsel for The Bond Market Association as Amicus Curiae

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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QUESTIONS PRESENTED *

Ohio's corporate franchise tax taxes gains on the sale of United States Treasury Bonds and other federal obligations, but excludes gains on the sale of comparable state obligations. This case presents the following questions:

1. Whether Ohio's discriminatory tax violates 31 U.S.C. § 3124(a), which bars "each form of taxation that would require the [United States] obligation, the interest on the obligation, or both, to be considered in computing a tax . . . ."

2. Whether Ohio's tax impermissibly discriminates against holders of federal obligations in violation of the intergovernmental tax immunity doctrine under the Supremacy Clause of the United States Constitution.

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* These questions are set out as stated in the petition.

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BRIEF OF THE BOND MARKET ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*

The Bond Market Association submits this brief as *amicus curiae* with the consent of the parties as specified in this Court's Rule 37.2(a).[1] The Bond Market Association represents securities firms and banks that underwrite, trade, and sell debt securities in the U.S. and international markets. *Amicus'* members deal in a wide variety of public and private debt securities, including state and municipal obligations as well as those issued by the Department of the Treasury and other entities of the federal government. All of the primary dealers in Treasury obligations, as recognized by the Federal Reserve Bank of New York, are members of the Association, along with

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[1] The written consents of the parties are on file with the Clerk of this Court.

other government securities dealers. From its inception in 1976,[2] the Association has addressed significant government securities issues that confront the industry, fostered sound credit, business, and trading practices for participants in the bond markets, and undertaken initiatives to improve market efficiency. Much of its work regarding federal obligations involves proceedings or actions taken by the Department of the Treasury's Bureau of the Public Debt.

The taxation of both state and federal obligations is of interest to *amicus* insofar as it bears on the effective functioning of markets for those debt obligations. In general, the markets are more efficient with evenhanded, predictable tax treatment of earnings and proceeds from debt securities. This is true for interest income, and it is equally true for gains and losses on dispositions of such securities, whether upon redemption at maturity or upon sale in the secondary market. In this latter respect, a viable, efficient secondary market in debt obligations provides strong support for the primary (new issues) market in such securities. *See* Department of the Treasury, Securities and Exch. Comm'n, and Board of Governors of the Fed. Reserve Sys., *Joint Report on the Government Securities Market* (Jan. 1992) (hereinafter *"Joint Report"*). Investors are more likely to purchase debt obligations if they have assurance that they need not necessarily hold the obligations to maturity but rather may sell them in a secondary market under competitive, efficient conditions.

This case addresses a franchise tax that is not evenhanded and that introduces a tax-based disadvantage into the secondary marketplace for federal debt (Treasury) obligations. Because of the importance of the secondary market in Treasury securities to *amicus* and its members, this brief is submitted to assist the Court in its evaluation of the petition for certiorari.

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[2] *Amicus* was previously named the Public Securities Association.

THE OHIO SUPREME COURT'S DECISION

This case deals with NACCO's investment in a bond issued by the U.S. Treasury, and the gain realized on the sale of that bond in the secondary market. Pet. 4. Under Ohio law, a corporation calculates its net income by including any net gains from the sale of federal obligations but not such gains from the sale of Ohio securities. *See* Pet. 4-5 (discussing Ohio Rev. Code Ann. §§ 5709.76(D) and 5733.04(I)). The Ohio Department of Taxation assessed a corporate franchise tax[3] on the gain from the sale of the Treasury bond, and NACCO appealed, first to the Ohio Board of Tax Appeals and then to the Ohio Supreme Court. Pet. 5-7.

The Ohio Supreme Court upheld the assessment, rejecting NACCO's claims that the taxation of gain on the Treasury bond was barred by 31 U.S.C. § 3124 and the intergovernmental tax immunity doctrine arising from the United States Constitution. Pet. App. 1a, 11a. As to Section 3124, the Ohio Supreme Court acknowledged that the statute operated to exempt federal obligations from state taxation,[4] but the Court held that Section 3124 did not apply to the taxation of a transaction between two private parties in which a Treasury bond was exchanged. Pet. App. 5a. The Ohio Supreme Court also concluded

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[3] Under Ohio Rev. Code Ann. § 5733.06, corporations pay a franchise tax calculated either on a net worth or a net income basis, whichever yields the greater liability. In NACCO's case, the income method resulted in a larger tax payment.

[4] The text of 31 U.S.C. § 3124(a) provides:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. *The exemption applies to each form of taxation that would require the obligation,* the interest on the obligation, or both, *to be considered in computing a tax,* except—(1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and (2) an estate or inheritance tax.

(Emphasis added.)

that the constitutional intergovernmental tax immunity doctrine did not prohibit Ohio's tax. Pet. App. 9a-11a. Although Ohio did not contest that its tax scheme treated gain from sales of federal and state obligations differently, Pet. 7, the Ohio Supreme Court considered that there was insufficient evidence that this "difference in treatment between state and federal obligations affect[ed] or impede[d] a function of the federal government; in this case, the marketability of federal obligations." Pet. App. 10a.

REASONS FOR GRANTING THE WRIT

By taxing gains on the disposition of federal obligations but not its own, Ohio "diminish[es] . . . the investment attractiveness of obligations issued by the United States." *Smith v. Davis*, 323 U.S. 111, 117 (1944). Obligations of the Treasury, which enable the U.S. government to satisfy its borrowing needs, constitute the largest, safest pool of debt instruments available to investors in the world. The size and liquidity of the secondary market in Treasury obligations allow investors to adjust their holdings quickly and conveniently, making the obligations attractive to individual, institutional, and governmental investors worldwide. Discriminatory state taxes, such as the Ohio corporate franchise tax at issue here, that burden this secondary market "in the slightest degree," *id.*, are barred both by the federal statute implementing the intergovernmental tax immunity doctrine, 31 U.S.C. § 3124(a), and by that constitutional doctrine itself.

The Ohio Supreme Court's decision to uphold the Ohio tax against statutory and constitutional challenges stands alone in recent jurisprudence. The decision conflicts with decisions by other state courts invalidating taxes that discriminated against federal debt obligations, *see Doneski v. Comptroller of the Treasury*, 605 A.2d 649 (Md. Ct. Spec. App. 1992) (Maryland income tax), *cert. denied*, 506 U.S. 1054 (1993); *Forbes, Inc. v. Department of Finance*, 487 N.E.2d 251 (N.Y. 1985) (New York City corporation tax), *cert. denied*, 475 U.S. 1109 (1986),

and stands in stark contrast to the tax scheme employed by the great majority of states (with Ohio, Connecticut, and Kansas in the small minority), which either equally tax gains from dispositions of both federal and state obligations, or tax gains from neither one, thus giving even-handed treatment. Certiorari should be granted to resolve the conflict in decisions between the Ohio Supreme Court and the state courts which have disapproved a discriminatory state tax law.

In holding that the federal intergovernmental tax immunity statute, 31 U.S.C. § 3124(a), does not pertain to taxation of gains realized from transactions in the secondary market for Treasury obligations, the Ohio Supreme Court ignored the fact that the statute by its own terms "applies to each form of taxation [requiring] the [federal] obligation . . . to be considered in computing a tax." This statute is "principally a restatement of the constitutional rule" of intergovernmental tax immunity, *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 397 (1983), and "it 'extends to *every form* of [state] taxation . . . [where federal obligations] must *be considered, directly or indirectly, in the computation* of the tax.'" *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 862 (1983) (quoting Rev. Stat. § 3701, 31 U.S.C. § 742, the immediate predecessor of 31 U.S.C. § 3124(a)) (emphasis in original). By contrast, the Ohio Supreme Court concluded that "the transaction subject to the tax does not arise directly from the relationship between the taxpayer and the federal government" but rather "from a contractual relationship between two private parties," Pet. App. 11a, disregarding that it is the appreciation in market value of a Treasury obligation that is being taxed. This Court should grant certiorari to correct the Ohio Supreme Court's interpretation of Section 3124(a) contrary to this Court's precedent.

Decisions of this Court, beginning with *McCulloch v. Maryland*, 4 Wheat (17 U.S.) 316 (1819), and continu-

ing to the present day, teach that the intergovernmental tax immunity doctrine of federal constitutional law, wholly apart from Section 3124(a), bars Ohio from imposing "a state tax . . . on those who deal with the Federal Government" when the tax "is [not] imposed equally on . . . similarly situated constituents of the State." *United States v. County of Fresno*, 429 U.S. 452, 462 (1977). Here Ohio's tax laws impermissibly discriminate in favor of its own state and municipal obligations, and certiorari should be granted to uphold the important constitutional interest.

I. OHIO'S DISCRIMINATORY TAX ON GAIN FROM DISPOSITION OF TREASURY OBLIGATIONS IMPERMISSIBLY DIMINISHES THE INVESTMENT ATTRACTIVENESS OF OBLIGATIONS ISSUED BY THE UNITED STATES

By taxing gains on the disposition of federal debt obligations, but not its own, Ohio burdens the secondary market for federal obligations and thus impermissibly "diminish[es] . . . the investment attractiveness of obligations issued by the United States." *Smith v. Davis*, 323 U.S. at 117.

By issuing Treasury obligations, the U.S. Government secures credit necessary to carry on its functions. The public debt of the United States, as of June 1997, amounted to over $5.37 trillion, approximately $3.43 trillion of which represents marketable securities. *See* Financial Mgmt. Serv., Department of the Treasury, *Treasury Bulletin* at 18-19 (Sept. 1997). In 1996, the Treasury auctioned over $2.4 trillion in marketable securities to the public, both to cover the budget deficit of the United States and to finance maturing debt. Because Treasury obligations are backed by the full faith and credit of the U.S. Government, Treasury obligations constitute the largest, safest pool of marketable debt instruments available to investors in the world.

The depth and liquidity of the secondary market for Treasury obligations substantially enhance the attractiveness of the obligations and ensure that the Treasury may offer them to the primary market at the best possible interest rate, thus minimizing the Treasury's cost of borrowing. The daily volume of secondary market transactions in Treasury securities involving primary dealers averaged approximately $204 billion in 1996. The high volume of secondary market trading ensures that investors are able to adjust their Treasury holdings quickly.[5] To manage the daily volume of trading in Treasury obligations, the U.S. Treasury relies on a well-connected network of primary dealers, nonprimary dealers, and interdealer and retail brokers who make competitive markets in Treasury obligations. *See Joint Report* at A-9 to A-10. As a result of the significant competition, secondary market dealers often charge commissions of as little as 1/32 of one percentage point on transactions in Treasury obligations, thus enabling investors to buy and sell Treasury securities at fair market prices. Because of the high liquidity and price efficiency of the secondary market, Treasury obligations

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[5] In enacting the Government Securities Act of 1986, Pub. L. No. 99-571, 100 Stat. 3208 (codified in scattered sections of 15 U.S.C.), and the Government Securities Act Amendments of 1993, Pub. L. No. 103-202, 107 Stat. 2344 (codified in scattered sections of 15 U.S.C.), Congress recognized the critical importance of the efficiency and liquidity of the secondary market for Treasury securities to the ability of the United States to obtain credit. The Acts, among other things, authorized the Department of the Treasury to promulgate rules and regulations governing brokers and dealers in government securities, *see* Government Securities Act of 1986, title I; Pub. L. No. 99-571, 100 Stat. at 3208-22 (codified at 15 U.S.C. § 78o-5 and in scattered sections of 15 U.S.C.); *see also* Government Securities Act Amendments, § 102, Pub. L. No. 103-202, 107 Stat. at 2345, 15 U.S.C. § 78o-5 (extending the Treasury's rulemaking authority); 17 C.F.R. pts. 400-405 (1997), and to set recordkeeping and reporting requirements for market participants with large positions in particular Treasury issues, *see* Government Securities Act Amendments of 1993, § 104, Pub. L. No. 103-202, 107 Stat. at 2346-48, 15 U.S.C. § 78o-5(f); 17 C.F.R. pt. 420 (1997).

are considered the equivalent of cash for a number of purposes and are widely held by individuals, pension funds, financial institutions, insurance companies, and other institutional investors, as well as foreign and domestic governmental investors.

Ohio, together with other states that discriminatorily tax capital gains on Treasury obligations, burdens the secondary market for Treasury obligations without imposing a like burden with respect to its own obligations. The intergovernmental tax immunity doctrine and the federal statute implementing it, 31 U.S.C. § 3124(a), bar any tax that discriminatorily affects the disposition of Treasury obligations in the secondary market, even "in the slightest degree." *Smith v. Davis*, 323 U.S. at 117. A tax that affected the disposition of a Treasury obligation in the secondary market by as little as one basis point (one hundredth of one percent), for example, could, given the high trading volume in Treasury obligations, result in wider spreads and impair the price efficiency and liquidity essential to the smooth operation of the secondary market.[6] A state may not, under the intergovernmental tax immunity doctrine and Section 3124(a), impose such a burden on the ability of the federal government to borrow money without shouldering the same burden with respect to its own borrowing power.

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[6] Investors purchase Treasury obligations for the purpose of deriving a positive return, and any reduction of the prospect for achieving such a return will tend to diminish the price investors are willing to pay for the obligation (and correlatively tend to increase the interest-rate cost to Treasury). A hypothetical increase of one basis point in the interest rate on the Treasury's marketable securities would increase the federal government's cost of borrowing by over $300 million per year.

In this respect, Ohio must believe that taxation of its own obligations would adversely affect the market for those obligations, or it would not have a provision in its State Constitution that bars such taxation. *See* Ohio Const., art. VII, § 2K(D)(4).

II. CERTIORARI SHOULD BE GRANTED TO RESOLVE THE CONFLICT BETWEEN THE DECISION OF THE OHIO SUPREME COURT TO UPHOLD THIS TAX AND DECISIONS BY OTHER STATE COURTS INVALIDATING SIMILAR TAXES

In upholding the Ohio statute taxing gains from the sale of federal debt obligations without taxing gains from the sale of Ohio obligations, the Ohio Supreme Court stands alone. Five years ago the Maryland Court of Special Appeals invalidated an equally discriminatory tax assessed by the State of Maryland on gains from the sale of federal obligations, concluding that "Maryland's taxation scheme . . . impermissibly discriminates against holders of federal obligations by diminishing the investment attractiveness of the United States obligations in favor of state obligations." *Doneski*, 605 A.2d at 653. The court in *Doneski* addressed the legality of a system under which Maryland never taxed the gain from the sale of its own obligations, while it taxed the gain realized from selling a federal obligation whenever the federal government did. After thoroughly reviewing the history of the intergovernmental tax immunity doctrine and Section 3124, the Maryland court opined that by rendering federal obligations less attractive to investors, Maryland was "increasing the cost and decreasing the value of [borrowed] funds to the federal government. Thus, [Maryland's] tax structure adversely affects the ability of the federal government to raise money and thereby violates the purpose of § 3124." *Id.* at 655 (citation omitted).

Although the tax at issue in *Doneski* was an individual income tax, as contrasted to the corporate franchise tax at issue here, the distinction does not affect the result. The Ohio Supreme Court, however, reached the opposite conclusion without citing *Doneski*.[7] The decisions are in direct conflict.

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[7] The Ohio Supreme Court could not have effectively distinguished *Doneski*, even if it had tried. The Ohio franchise tax is essentially

Also prior to the decision of the Ohio Supreme Court at issue, the Court of Appeals of New York had struck down a tax scheme that disadvantaged investors in federal obligations. In *Forbes, Inc. v. Department of Finance*, 487 N.E.2d 251, the court considered the New York City General Corporations Tax, which employed a formula that treated federal obligations differently from other investments. The court explained that "the City tax unquestionably imposes a greater burden on holders of Federal obligations than on holders of certain other obligations, and thereby diminishes to some degree the investment attractiveness of Federal obligations." *Id.* at 256. After surveying the history of Section 3124(a), the court held the tax system to be impermissible because "the statutory goal of preserving Federal borrowing power is threatened whenever any other class of obligations is taxed more leniently than Federal obligations." *Id.* at 257. This decision by New York State's highest court also directly conflicts with that of the Ohio Supreme Court.

Previously at least one state revenue department expressly recognized that a tax such as that imposed by Ohio would be illegal. *See* Pennsylvania Dep't of Revenue Tax Update No. 16, at 4 (July 1987) ("Ask Revenue" column):

> Q: Is the gain on the sale of Federal obligations exempt for Pennsylvania corporate net income tax purposes?
>
> A: Yes. Since the *C.C. Collings* case requires the Department to exclude from taxable income gains derived from the sale of Pennsylvania state and municipal obligations, the Department is constitutionally obligated to exclude from taxable income the

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an income tax, based as it is on the corporation's net income. *See* Pet. 4; Pet. App. 2a. Additionally, although Section 3124 contains an exception for "a nondiscriminatory franchise tax," the State has not contended that Ohio's corporate franchise tax falls within this exception.

> gains derived from the sale of Federal obligations. This position is consistent with the Department's position of excluding interest on Federal obligations from taxable income. The exclusions of gains derived from the sale of Federal obligations is also consistent with the Pennsylvania Supreme Court's holding in *Commonwealth v. Curtis Publishing Co.*, 363 Pa. 299, 69 A.2d 410 (1949).

Also, a Michigan statute by its own terms provides that the State is "prohibited by law" from subjecting gains and losses on the sale or exchange of federal obligations to the State's income tax:

> "Taxable income" means . . . adjusted gross income as defined in the internal revenue code subject to the following adjustments
>
> . . . .
>
> (c) Add losses on the sale or exchange of obligations of the United States government, the income of which this state is prohibited from subjecting to a net income tax, to the extent that the loss has been deducted in arriving at adjusted gross income.
>
> (d) Deduct, to the extent included in adjusted gross income, income derived from obligations, or the sale or exchange of obligations, of the United States government that this state is prohibited by law from subjecting to a net income tax, reduced by any interest on indebtedness incurred in carrying the obligations and by any expenses incurred in the production of that income to the extent that the expenses, including amortizable bond premiums, were deducted in arriving at adjusted gross income.

Mich. Comp. Laws § 206.30(1).

To date, very few states have tried to do what Ohio has done here: favor their own state bonds over obligations issued by the federal government. Currently, Kansas and Connecticut (in addition to Ohio) tax gains on dispositions of federal obligations while not taxing gains on

their own obligations.[8] Certiorari should be granted to resolve this conflict now, so states can be properly guided in choosing their tax structures.

III. CERTIORARI SHOULD BE GRANTED TO CORRECT THE OHIO SUPREME COURT'S MISINTERPRETATION OF SECTION 3124 AND MISAPPLICATION OF THIS COURT'S PRECEDENTS CONSTRUING THAT STATUTE

Section 3124(a) in one form or another has been in place since the Civil War and is considered "principally a restatement of the constitutional rule." *Memphis Bank & Trust Co.*, 459 U.S. at 397 (citing *New Jersey Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665, 672 (1950); *Missouri ex rel. Missouri Ins. Co. v. Gehner*, 281 U.S. 313, 321-22 (1930)). The statute "establishe[s] Congressional intent to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Smith v. Davis*, 323 U.S. at 117. In 1959, to thwart attempts by a few states to use a back-door method to tax federal obligations, Congress added a second sentence to the original statute: "This exemption extends to every form

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[8] Several other states tax gains and income on federal obligations to the extent that such taxation is consistent with the U.S. Constitution and their state constitutions. *E.g.*, Kentucky's definition of "[a]djusted gross income" for state tax purposes "[e]xclude[s] income that is exempt from state taxation by the Kentucky Constitution and the Constitution and statutory laws of the United States and Kentucky." Ky. Rev. Stat. Ann. § 141.010(10)(a). Similarly, for its own taxation Oklahoma adapts the amount of federal adjusted gross income by "deduct[ing] amounts included in such income that the state is prohibited from taxing because of the provisions of the Federal Constitution, the State Constitution, federal laws or laws of Oklahoma." Okla. Stat. tit. 68, § 2358.A.2. The disposition of this case, and, indeed, the petition for certiorari itself, may affect the position of these other states respecting the coverage of their tax laws.

of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except— nondiscriminatory franchise . . . taxes . . . ." Pub. L. 86-346, § 105(a), 73 Stat. 621. The Senate Report to the bill that became law explains that the added sentence "makes it clear that the exemption for Federal obligations extends to every form of taxation that would require . . . the obligation . . . to be considered directly or indirectly in the computation of the tax, except nondiscriminatory franchise taxes . . . ." S. Rep. No. 86-090, at 5-6 (1959), *reprinted in* 1959 U.S.C.C.A.N. 2769, 2773-74.

In "reject[ing] and set[ting] aside" the "rather formalistic pre-1959 approach to § 3701," Congress created a "sweeping" exemption for federal obligations. *American Bank & Trust Co.*, 463 U.S. at 862. The Court in *American Bank & Trust* explained that the sentence added in 1959 makes clear that a tax "is barred regardless of its *form* if federal obligations must be considered, either directly or indirectly, in *computing* the tax." *Id.* (emphasis in original). In *American Bank & Trust*, the Court struck down a Texas bank tax computed by including the value of the federal obligations held by the banks. 463 U.S. at 860. Earlier that same Term, in *Memphis Bank & Trust*, the Court struck down a Tennessee bank tax on "net earnings" where "net earnings" was defined to include income on federal obligations but exclude income on Tennessee obligations. 459 U.S. at 393.

As this Court explained in *Nebraska Dep't of Revenue v. Loewenstein*, 513 U.S. 123, 128-29 (1994) (quoting *American Bank & Trust Co.*, 463 U.S. at 862), "[t]he obligation itself is 'considered' [in the computation of tax] when its value is 'taken into account, or included in the accounting.'"[9] The Ohio Supreme Court, however, did

[9] *Loewenstein* addressed repurchase agreements in which credit was extended with federal obligations used as collateral. Interest

not address whether taxing the gain from the sale of a federal obligation required the taxpayer to take the "value" of that obligation "into account." Instead the court limited its inquiry to whether the word "gain" is included in the text of the exemption. *See* Pet. App. 4a ("By its terms, the immunity expressed in Section 3124(a) does not extend to gains from the sale of federal obligations."). This Court's prior interpretations of Section 3124(a), however, dictate a different approach.

As the predicate for its focus on the absence of the word "gain" in Section 3124(a), the Ohio Supreme Court looked to the language of Section 3124(b), which speaks to "the tax treatment of gain and loss from the disposition of [federal] obligations." In so doing, the Ohio Supreme Court "presumed [that Congress had] act[ed] intentionally and purposely when it include[d the] particular language [regarding gains and losses] in one section of [the] statute but omit[ted] it in another." Pet. App. 4a. The two provisions, however, have very different histories, and have only recently been placed together in the same section of the U.S. Code. No inference from the differing language can be drawn. *See Gozlon-Peretz v. United States*, 498 U.S. 395, 404-05 (1991) (employing this principle where a single enactment contained provisions with differing language).

The constitutional doctrine of intergovernmental tax immunity was solely a matter of this Court's jurisprudence until the Civil War. *See Smith v. Davis*, 323 U.S. at

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was paid on the cash extension of credit. The Court held that Section 3124(a) was not implicated by this extension of credit because the role of the federal obligations was purely as collateral, *see* 513 U.S. at 130-31, and that any other form of "collateral [with] sufficient value and liquidity" would have served as well. *Id.* at 131.

Also in *Loewenstein* the Court was explicit that any "repos" using Nebraska's own state and local obligations as collateral would be treated no differently than where federal obligations were so used. *See* 513 U.S. at 135-36.

114-15. When Congress passed the Act of Feb. 25, 1862, ch. 33, 12 Stat. 345, the doctrine also became embodied in a federal statute. That statute and six other statutes were first combined into Section 3701 of the Revised Statutes and then recodified in 1925 as 31 U.S.C. § 742, see *Smith v. Davis,* 323 U.S. at 117 & n.7, and the language of that statute remains virtually unchanged as the first sentence of the present Section 3124(a). In contrast, United States obligations were exempt from federal taxes only until 1941, when Congress enacted the Public Debt Act of 1941, removing their federal tax exempt status. That statute, as amended, is the present Section 3124(b). In 1982, these two separate statutory provisions were recodified as subsections (a) and (b) of Section 3124, Pub. L. No. 97-258, § 3124, 96 Stat. 877, 945. The recodification and combination was not intended to change the meaning of either provision. *See Rockford Life Ins. Co. v. Illinois Dep't of Revenue,* 482 U.S. 182, 183 n.1 (1987).

In all events, as the Maryland Court of Special Appeals recognized in *Doneski,* the inclusion of the terms "gain" and "loss" in § 3124(b) "would be necessary only if section (a) prohibits taxing the gain." 605 A.2d at 651. The Ohio Supreme Court did not consider this theory of how the statute should be construed, but instead focused on a "negative pregnant" construction of Section 3124(a). *Field v. Mans,* 516 U.S. 59, 75 (1995). In *Field,* this Court explained that application of this rule of construction should be "limited," noting that "[t]he more apparently deliberate the contrast, the stronger the inference" to be drawn from the absent language. *Id.* Given the divergent histories of the two provisions, there is no evidence supporting a conclusion that the distinction between (a) and (b) was "deliberate" or meaningful in any respect.

In short, the Ohio Supreme Court's decision that Section 3124(a) was not applicable is at odds with this Court's interpretation announced in *Memphis Bank &*

Trust and *American Bank & Trust* of the effect of the 1959 amendment to the statute. There is nothing in the post-1959 history, including the 1982 recodification, that affects this Court's interpretative rulings on the statute. Certiorari should be granted to address the disparity between the Ohio Supreme Court's interpretation of Section 3124(a) and this Court's prior rulings.

IV. THE OHIO SUPREME COURT'S DECISION CONTRAVENES THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE OF FEDERAL CONSTITUTIONAL LAW

Certiorari also should be granted because the Ohio Supreme Court decided a question at the heart of the intergovernmental tax immunity doctrine in a way that contravenes decisions of this Court.[10] Beginning with *McCulloch v. Maryland*, 4 Wheat. (17 U.S.) 316, this Court has ruled that a State may not impose taxes directly on the federal government, nor may a State tax someone who holds federal instruments or obligations or who deals with the federal government if that taxation is not "in common with other property of the same description throughout the State." *Id.* at 436. The latter prong of the intergovernmental tax immunity doctrine has been distilled by this Court into an anti-discrimination rule:

> The rule to be derived from this Court's more recent decisions, then, is that the economic burden on a fed-

[10] That the constitutional question under the intergovernmental tax immunity doctrine arises separately from the statutory exemption provided by Section 3124(a) is apparent from this Court's analysis in *Loewenstein*. After first addressing the Nebraska tax under Section 3124(a), and concluding that the statute did not apply, the Court addressed whether the tax was forestalled by the constitutional doctrine. *Loewenstein*, 513 U.S. at 135-37. *See also Rockford Life Ins.*, 482 U.S. at 188 ("[W]e shall first decide whether the statute requires that Ginnie Maes be exempted from state property taxes, and then consider whether the constitutional doctrine of intergovernmental tax immunity requires any broader exemption.").

> eral function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituent of the State.

County of Fresno, 429 U.S. at 462. The Ohio Supreme Court accepted that the franchise tax in Ohio taxes gains on dispositions of federal obligations and not state obligations. It nonetheless refused to apply the constitutional test by ruling that NACCO had not surmounted a relatively high evidentiary hurdle.[11] The barrier thus imposed contravenes this Court's precedents.

This Court has tailored the proofs required to invoke the intergovernmental tax immunity doctrine for two separate situations, one where the tax discriminates against those who deal with the federal government and the other where the tax is not discriminatory. Where discrimination is shown, the Court has adopted a virtual *per se* test. *See Smith v. Davis*, 323 U.S. at 117 (prohibiting discriminatory state taxes that burden Treasury obligations "in the slightest degree"); *Willcuts v. Bunn*, 282 U.S. 216, 229 (1931). By contrast, where the tax is not discriminatory, the challenger must establish that a federal governmental function or instrumentality is directly burdened or impaired. In this latter respect, in *Willcuts v. Bunn*, the Court referred to

> subjects which fall within the general application of nondiscriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government.

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[11] The Ohio Supreme Court held that NACCO had not shown that the federal government's functions had been adversely affected or impeded, Pet. App. 10a, and that the relationship of the federal government to the private sale of the Treasury bond in the secondary market was "too attenuated" to invalidate the Ohio franchise tax on the gain from the sale. Pet. App. 11a.

288 U.S. at 225. *See also Loewenstein*, 513 U.S. at 135-37; *Rockford Life Ins.*, 482 U.S. at 189-191; *County of Fresno*, 429 U.S. at 460.

In this case, the Ohio Supreme Court was addressing a discriminatory tax, yet it applied the evidentiary tests that have been employed in evaluating nondiscriminatory systems of taxation.

This distinction in evidentiary requirements between cases addressing discriminatory and evenhanded taxes has parallels in this Court's jurisprudence involving the dormant Commerce Clause. *Compare City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978) (applying a "virtually *per se* rule of invalidity" to laws that discriminate on their face), *with Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) (requiring evenhanded law to be "upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits"). Another analog is found in this Court's decisions applying the Privileges and Immunities Clause. *See Toomer v. Witsell*, 334 U.S. 385, 396 (1948) (requiring, once discrimination against nonresidents is demonstrated, a "substantial reason for the discrimination beyond the mere fact that they are citizens of other States"). *See also Lunding v. Tax Appeals Tribunal of the State of New York*, No. 96-1462 (argued November 5, 1997).

The intergovernmental tax immunity doctrine is derived from several different parts of the U.S. Constitution—the Tax Clause, art. I, § 8, cl. 1, the Borrowing Clause, art. I, § 8, cl. 2, the Supremacy Clause, art. VI, cl. 2, and the structure of the Constitution relating to the roles of the federal government and of the States. *See McCulloch v. Maryland*, 4 Wheat (17 U.S.) at 425-436. Each of these elements has its place in shaping the doctrine. This case touches most directly on the Borrowing Clause, and certiorari should be granted to enable the Court to consider whether the decision of the Ohio Supreme Court has sub-

merged the import of that clause and thus has distorted the doctrine itself.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

PAUL SALTZMAN
SARAH M. STARKWEATHER
THE BOND MARKET ASSOCIATION
40 Broad Street
New York, NY 10004-2373

ERIKA W. NIJENHUIS
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, NY 10006-1470

December 24, 1997

CHARLES F. LETTOW
(Counsel of Record)
GIOVANNI P. PREZIOSO
ONNIG H. DOMBALAGIAN
ABBY F. RUDZIN
CLEARY, GOTTLIEB, STEEN & HAMILTON
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006-1801
(202) 974-1500
Counsel for The Bond Market Association as Amicus Curiae

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

NACCO INDUSTRIES, INC.,

Petitioner,

v.

ROGER W. TRACY, TAX COMMISSIONER OF OHIO,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Ohio

REPLY OF THE PETITIONER

TIMOTHY B. DYK
(Counsel of Record)
GREGORY A. CASTANIAS
PAUL R. REICHERT
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

CHARLES M. STEINES
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939

Counsel for Petitioner

REPLY OF THE PETITIONER

Nothing in the Respondent's Brief in Opposition ("Opp.") diminishes either the conflict between the decision below and this Court's precedents or the importance of this case.

1. Respondent's claim that the petition presents issues insufficiently important for certiorari cannot be squared with the views of the United States ("U.S. Br.") that the petition presents issues "of broad recurring importance" (U.S. Br. 11); the views of *amicus curiae* the Bond Market Association ("BMA Br.") that "certiorari should be granted to uphold the important constitutional interest" at stake in this case (BMA Br. 6); or the views of the Committee on State Taxation ("COST Br.") that the Ohio Supreme Court's decision "dramatically limit[s] the reach of both the statutory and constitutional intergovernmental tax immunity doctrines" (COST Br. 4).

2. Respondent's brief in opposition barely touches upon NACCO's argument that the Ohio tax violates the constitutional doctrine of intergovernmental immunity (*see* Pet. 16-20). Indeed, neither Respondent's restatement of the questions presented (Opp. i), nor his arguments, responds to NACCO's showing that the decision below conflicts with this Court's intergovernmental tax immunity decisions, most notably *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). As NACCO showed in the Petition, Ohio's clear and admitted differential taxation of gain from the sale of federal and state obligations "impermissibly discriminates" against federal obligations. *Id.* at 397. That is the position of the United States (U.S. Br. 6-11), as well as the other *amici* (BMA Br. 6-8; COST Br. 3-7); indeed, the existence of this discrimination was even acknowledged by the Ohio Supreme Court below (Pet. App. 10a).

3. Respondent's defense to NACCO's showing of impermissible discrimination is limited to arguing that the decision below rests on an unreviewable "factual finding" (Opp. 3). As NACCO explained in the Petition (Pet. 18-20), and as the Solicitor General has reiterated in his brief (U.S. Br. 8-10), the Ohio court erred as a matter of law by announcing a new rule of law that requires taxpayers to prove not only the existence of discrimination, but

also that the discrimination "affects or impedes a function of the federal government" (Pet. App. 10a). Of course, discrimination against federal obligations perforce "impedes" the marketability of federal obligations; this Court's decisions have never imposed the further requirement that complex factual economic proof be presented to sustain such a discrimination claim or a requirement that the overall impact of the tax be evaluated. As the Solicitor General properly notes, "there is no authority for the [Ohio] court's proposition that an established discrimination against a holder of federal property may be permitted because of the speculative possibility that a compensating advantage might exist elsewhere in the state tax scheme in some other year or for some other holder of federal property" (U.S. Br. 9).

Indeed, as noted by the United States (U.S. Br. 7-8), this Court's decisions cannot possibly be read to support that proposition. The two cases relied upon by the Ohio Supreme Court — *Willcuts v. Bunn*, 282 U.S. 216 (1931) and *Rockford Life Insurance Co. v. Illinois Department of Revenue*, 482 U.S. 182 (1987) — both involved *nondiscriminatory* taxes. In those circumstances, where state and federal obligations were treated evenly, it was quite proper for the Court to require a showing of actual interference with the marketing of federal securities in order to strike down the tax. As has been explained previously by petitioner and all *amici* (Pet. 16-17 & n.8; U.S. Br. 7-8 & n.5; BMA Br. 17-19; COST Br. 7 & n.2), the issue of discrimination is quite different than, and analytically distinct from, the question of whether a state tax actually interferes with the borrowing power of the United States. No showing of interference is required where the tax is discriminatory.

4. NACCO also showed in the Petition (Pet. 10-16) that the Ohio Supreme Court's decision rests upon a fundamental misinterpretation of 31 U.S.C. § 3124(a), and conflicts with this Court's decisions interpreting that statute — most notably *Nebraska Department of Revenue v. Loewenstein*, 513 U.S. 123 (1994). As NACCO showed (Pet. 10-16), and as the Solicitor

General has explained (U.S. Br. 8 n.5), this Court's decision in *Loewenstein* cannot remotely support the decision below.[1]

In response, Respondent simply reiterates the misguided application of the "negative pregnant" canon of statutory construction relied upon by the court below (Pet. App. 4a-5a). Respondent's argument leads only to absurd conclusions. Respondent claims (Opp. 9-10) that because Congress in section 3124(b) used the term "gain and loss from the disposition of those obligations and evidences of ownership," section 3124(a) (which does not contain that phrase) must not prohibit state taxation of "gain and loss from the disposition of those obligations." Section 3124(b), of course, also uses the term "dividends, earnings, or other income from evidences of ownership issued by the Government," but section 3124(a) does not contain this language. Thus, if carried to its logical end, Respondent's "negative pregnant" argument would lead to the conclusion that state taxation of "dividends, earnings, or other income" would also not be prohibited by section 3124(a). That is clearly not the case. *See, e.g., American Bank & Trust Co. v. Dallas County,* 463 U.S. 855 (1983) (striking down, under predecessor to section 3124(a), state tax on bank earnings).

5. Respondent totally fails to reconcile the Ohio Supreme Court's approval of a state tax on "gain" — defined by *Black's Law Dictionary* (at 678 (6th ed. 1990)) as "[a]ppreciation in value or worth" — with this Court's repeated statements that an obligation is "considered" for purposes of section 3124(a) "when its *value* is 'taken into account, or included in the accounting,' in computing the taxable value of a taxpayer's assets or net worth." *Loewenstein,* 513 U.S. at 128-29 (emphasis added); *American Bank & Trust Co.,* 463 U.S. at 862; *see* Pet. 12. Respondent

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[1] Respondent's efforts to diminish the importance of *Loewenstein* to the Ohio Supreme Court's decision (Opp. 6-7) cannot be reconciled with the Ohio Supreme Court's erroneous view that "the dispositive question in this case" is "simila[r]" to that presented in *Loewenstein* (Pet. App. 5a).

offers no explanation for this obvious conflict between the Ohio court's statutory construction and this Court's decisions interpreting section 3124(a).

6. Finally, Respondent's suggestion (Opp. 12) that "further development" is needed in this area is unsupported and unsupportable — Ohio's highest court has now definitively spoken on this issue, so "further development" cannot possibly take place with respect to the Ohio statute. Discrimination against federal obligations also exists under the tax structures of Connecticut and Kansas (Pet. 21; BMA Br. 5), and the Ohio decision will encourage further discriminatory legislation.

This Court should not await further discrimination or litigation which cannot possibly affect the situation in Ohio. The Ohio Supreme Court's approval of discrimination against federal obligations also has the potential to cause a huge increase in the Federal Government's cost of borrowing (BMA Br. 8 & n.6). As the Solicitor General has stated (U.S. Br. 11), this holding "interferes with the extraordinarily important federal function of marketing trillions of dollars of United States obligations." Similarly, the Bond Market Association has concluded that even a slight tax burden affecting the disposition of federal obligations in the secondary market could "result in wider spreads and impair the price efficiency and liquidity essential to the smooth operation of the secondary market" for federal obligations (BMA Br. 8).

CONCLUSION

For the foregoing reasons and those stated in the petition, certiorari should be granted.

Respectfully submitted,

TIMOTHY B. DYK
(Counsel of Record)
GREGORY A. CASTANIAS
PAUL R. REICHERT
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939

CHARLES M. STEINES
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939

Counsel for Petitioner

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